THE ISLAMIC ECONOMY

Analytical Study of the Functioning of the Islamic Economic System

by

Dr. Monzer Kahf

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INTRODUCTION

THE NEED FOR A GENERAL THEORY OF THE ISLAMIC ECONOMY

The collection of works on Islamic economics contains a number of volumes that are very important and valuable. It provides Muslim readers with substantial works explaining the essential principles of the economic system in Islam. There is little, however, on the mechanism of the functioning of this system. Even more scarce are the writings that interrelate the different facets of the Islamic economic system and form one whole theroretical structure that is internally consistent and externally valid.

The study that is presented in this book attempts to fill this gap in modern Islamic economic thought. Its author submits that this study was made possible only by the tremendous efforts which were made by previous writers,since those efforts laid the ground and prepared the framework for the current study. The author is therefore deeply indebted to all that has been written previously on Islamic economics.

The name of this work was selected to express its nature. It is an attempt to build general theory because it pulls together all the lines of the Islamic economic system, analyzes their interrelationships and examines their consistency. On the other hand, it is a study of the Islamic economy rather than the Islamic economic system because it concentrates on the functioning of the Islamic principles of the economy rather than describing these principles. It attempts to answer the question that is frequently faced by the ordinary Muslim who is puzzled when he is confronted with the Islamic injunctions which tell him, for example, to pay *Zakat*, avoid financial speculation and eliminate interest, without providing him

with any explanation of the economic consequences of such injunctions, and thus he asks: "Then what will happen to our economy? And how will it happen?"

This study takes as precepts the Islamic teachings in economics; it does not occupy itself with their legal and ideological justification but rather it goes on to investigate their economic significance and implications. In other words, the Islamic economy is given by assumption in this study. Its purpose is to show how this economy works and how its major variables are determined, such variables as investment, savings, consumption, etc. It focuses on the effects of such variables as are generated by the Islamic injuctions themselves.

Consequently, this work tackles the issues of the market structure and general equilibrium of the Islamic economy. While the general situation of the Islamic economy is presented as a coherent body, particular problems such as nationalization, the role of the state, development planning, etc., are treated, when the need arises, as special cases within the framework of the general theory. On the other hand, issues such as economic growth and economic policy are linked directly to the general theory of the Islamic economy because such issues arise from the system's own methods of promoting the general equilibrium.

The author does not claim any comprehensiveness or exclusiveness. This work should therefore be taken as an individual effort relating to the economics of Islam and not as *the* only expression of Islamic economics. The views and ideas in this book represent those of the author. Although many of them are shared with others, he remains exclusively responsible for any error in them.

This book consists of six chapters. Chapter One introduces the Islamic economics and its methodology. Chapters Two and Three deal with consumption and production theories respectively. Chapter Four investigates the market structure, while chapters Five and Six construct the macroeconomic model and study its policy implications.

October 20, 1978

Monzer Kahf

Chapter I

ISLAMIC ECONOMICS AND ITS METHODOLOGY

Religion and Economics

To understand the relationship between religion in general and economics, one must study their respective domains and fields of operation, and examine whether they overlap and in what aspect.

Religion is defined by Reville as "the determination of human life in accordance with a bond between the human soul and a mysterious Soul, whose domination over himself and the world man recognizes and to Whom he likes to feel attached."[1] Michel Mayer, in his book, *"Instructions Morales et Religieuses, lére leson,"* defines religion as "the set of beliefs and precepts which must guide us in our conduct toward God, other people and toward ourselves."[2] Religion is summarized by M. 'Abdullah Draz as "a chart of conduct."[3]

These definitions imply that part of the domain of religion is human behavior in all its stages and aspects. This includes before all else the beliefs that determine such behavior and its ultimate objectives.

Economics is usually defined as the study of human behavior in relation to using scarce productive resources to produce goods and services and distribute them for consumption.[4] The field of economics is thus one sector of human behavior which is related to production, distribution and consumption. It is apparent from comparing the definition of economics with that of religion that the former deals with a subset of the domain of the latter. One

[1]Muhammad Abdullah Draz. *Al-Dīn*. Kuwait: Dār al-Qalam, 1970, Second Edition, p. 35.
[2]*Ibid.*, p. 36.
[3]*Ibid.*, p. 31.
[4]Paul A. Samuelson. *Economics*. New York: McGraw-Hill Book Co., 1973, Ninth Edition, p. 3; see also Eduian Mansfield. *Microeconomics*. New York: W.W. Norton and Co., 1970, p. 1.

should, therefore, expect that any religion must have its say concerning the way man organizes his economic activities. Every religion has its own 'Economic Ten Commandments.'

In the Holy Qur'an Allah Subhanahu wa Ta'ala gives several emphatic examples of the teachings of earlier Prophets in relation to economic affairs in order to stress the fact that economic behavior is one of the areas of concern of religion. Regarding the prophetic missions of Abraham and his sons, Allah says:

> "And We made them leaders, guiding by Our command, and We sent them inspiration to do good deeds, to establish prayers and to practice *Zakah;* and they constantly served Us."[5]

The message of the Prophet Shu'aib was basically an economic message. The Qur'an reports him as saying:

> " 'Will you not fear Allah? I am to you an apostle worthy of all trust. So fear Allah and obey me. No reward do I ask of you for it; my reward is only from the Lord of the Worlds. Give just measure and cause no loss (to others by fraud). And weigh with scales true and upright. And do not withhold things justly due to men, nor do evil in the land, working mischief.' "[6]

Accordingly, from the beginning of Islam in Makkah, even before the establishment of the Islamic society of al-Madinah, the verses of the Qur'an had presented the Islamic position on the relationship between religion and belief in Allah and the Day of Judgment on one hand and the economic behavior and the economic system on the other. Allah Subhanahu wa Ta'ala says:

> "Woe to those who deal in fraud—those who, when they have to receive by measure from men, exact full measure, but when they have to give by measure or weight to men, give less than due. Do they not think that they will be called to account on a Mighty Day, a Day when (all) mankind will stand before the Lord of the Worlds?"[7]

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[5] *The Holy Qur'an*, 21:73. The basic translation used throughout this book is that of 'Abdullah Yusuf 'Ali, with some modifications.

[6] 26:178-183.

[7] 83:1-6.

and:

> "That which you lay out for increase through the property of (other) people will have no increase with Allah; but that which you lay out for charity, seeking the Countenance of Allah, (will increase); it is these who will get a recompense multiplied."[8]

These verses, revealed in Makkah, condemn the prevailing economic behavior and provide early hints of the anticipated economic system which is consistent with this religion. It is noteworthy that these verses relate economic behavior to the doctrine of accountability before Allah on the Day of Judgment.

Although all religions deal with economic matters, they differ in their stand concerning economic activities. Certain religions look at the economic activities of man only as a necessity of life which ought to be undertaken only to the extent that provides him with mere sustenance, considering any further economic exercise beyond that limit as a misorientation of human resources or some sort of evil. Accordingly, such religions consider those who are less involved in economic activities to be closer to God. Wealth is in itself an evil.[9] However, Islam, on the contrary, considers the economic activities of man as an aspect of the fulfillment of his responsibility on this earth. The more man is involved in economic activities, the better he can be, provided his life is kept balanced. Piety is not a positive function of economic unproductivity. The more pious one is, the more productive he should be.[10] Wealth is in itself good and its pursuit is a legitimate aim of human behavior, since economically productive work is a religious value in itself, etc.[11]

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[8]30:39.

[9]See, for example, *The New Testament:* Matthew, Chapter 19, verses 24-26, in which Jesus is reported as saying

"And again I say unto you, It is easier for a camel to go through the eye of a needle, than for a rich man to enter into the kingdom of God. When his disciples heard it, they were exceedingly amazed, saying, Who then can be saved? But Jesus beheld them, and said unto them, With men this is impossible; but with God all things are possible."

[10]Allah says in the Qur'an:

"Allah sets forth a parable of two men: one of them dumb, with no power of any sort; he is a wearisome burden to his master; whichever way he directs him, he brings no good. Is such a man equal to one who commands justice and is on a straight way?" (16:76)

[11]Mustafa al-Siba'i, *Ishtirakiat al-Islam,* Damasucs: Dar al-Matbu'at Al-Arabiyah, Second Edition, 1960, pp. 52-55; and Muhammad al-Mubarak, *Nizam al-Islam, al-Iqtisad.* Beirut: Dar al-Fikr, 1972, pp. 19-42.

Methodology of Islamic Economics

Any economic system should be founded on an ideology which provides the economic system with its basis and objectives on one hand, and with its axioms and principles on the other. The process followed by the set of axioms and principles in order to bring the economy closer to the objectives of the system represents the testable ground of the system. Any economic system draws up a framework within which a socio-economic community can utilize natural and human resources for production and distribute the fruits of this production for consumption. The validity of an economic system can be tested by its internal consistency, its compatibility with the systems organizing the other aspects of life, and its provision for improvement and growth. An economic system is therefore not expected to provide, for example, the specific composition of the exports of a certain country, a practically useful and mathematically manageable production function, or a proposition as to how to aggregate individual demand functions into a nationally aggregate demand. Such components of the economic theory cannot be initiated by the system since they arise in the practical application of the system under a given set of conditions. It is in the light of these conditions and within the framework of a prevailing economic system that such elements of the economic theory can be developed, tested and theorized.

Consequently a system for the Islamic economy should be formulated on the basis of the Islamic doctrine of life. The axioms and principles of such a system should be stipulated and the process of its functioning should be clarified in order to show its purity and applicability. A lucid distinction, however, should be drawn between the economic system of Islam and any subset of it. In Islamic literature on economics, little attention has been given to this matter. As a result of this, several works claiming to discuss the 'Islamic economic system' in fact deal only with the jurisprudential background of it, or sometimes with the economic principles of Islam. A study of the economic principles only falls short of a study of the economic system, just as a study of the grammar of a language falls short of creating an oratorical skill.

Moreover, a distinction must be made between that part of Islamic jurisprudence which deals with business law *(Fiqh al-Mu'amalat)* and Islamic economics. The former draws up the legal framework for the latter, while the latter studies the process and outcome of human activity relating to production, distribution and consumption in an Islamic society. Islamic economics is con-

strained by the Islamic laws of business, but this is not the only constraint on the study of economics. The Islamic social system and religious precepts exert as much influence, if not even more, on the economic domain as does the legal system. The lack of such a distinction between *Fiqh al-Mu'amalat* and Islamic economics has been another source of the misconceptions in the modern literature on Islamic economics. Several works have used the tools of analysis of *Fiqh* in economics, while several others have studied the economics of Islam from the point of view of *Fiqh*. For example, the consumption theory sometimes becomes a restatement of the Islamic laws concerning foods and drinks, instead of being a study of the behavior of the consumer toward the package of available consumer goods, and the theory of production is reduced to a study of the right of ownership in Islam instead of being focused on the behavior of the firm as a productive unit.

Another great disadvantage in thinking of Islamic economics in terms of *Fiqh al-Mu'amalat* is that such an approach is, by its nature, fragmented and it loses the overall thrust of the economic theory. This has perhaps been responsible for the noticeable absence of a macroeconomic monetary theory in all the present literature on Islamic economics. In order to compensate for this shortcoming, half of this book has been devoted to the macroeconomic monetary theory of the Islamic economy.

The study of history is very important for economics because history is the laboratory of humanity. Economics, as one of the social sciences, needs to resort to history in order to carry out its experiments and to derive the long-term trends of the economic variables. History provides economics with two major indispensable aspects, namely, the history of economic thought and the history of economic units such as individuals, firms and economics.

Little has been done to present the history of Islamic economic thought. This is unfortunate because throughout the history of Islam Muslim thinkers and political leaders have developed their economic ideas to the extent that allows us to look to them as the real founders of Islamic economics. Research is needed to bring to light the economic thinking of great Islamic thinkers such as Abu Yusuf, (died 182 H.), Yahya bin Adam, (died 303 H.), al-Ghazali, (died 505 H.), Ibn Rushd, (died 595 H.), al-'Izz bin Abdus-Salam (died 660 H.), al-Farabi (died 339 H.), Ibn Taymiyah (died 728 H.), al-Maqreezi (died 845 H.), Ibn Khaldoon (died 808 H.), and many others.

Such a study of the history of economic thought in Islam would

help in discovering the roots of contemporary Islamic economic thought on one hand, and it would allow us to obtain a better understanding of the journey of Islamic economic thought through time on the other. Both of these enrich contemporary Islamic economics and open a broader scope for its conceptualization and application.

The study of the historical development of Islamic economies provides the empirical tests that are needed for any economic ideas. This is of great importance, especially in the area of economic policy and public finance. But a warning of two dangers must be voiced when the historical aspect of Islam is investigated. First, the danger of confusing the theory with some of its applications, and second, the danger of restricting the theory to its history. The first danger arises when modern Muslim economic thinkers do not distinguish clearly between an Islamic conception and its historical applications. This is particularly apparent in the area of public finance, for almost every work on public finance that exists in the contemporary Islamic library considers the state resources as those which were in existence at the time of the great Islamic state, from 'Umar b. al-Khattab to Haroon al-Rashīd. Very little attention is given to developing a theory of public finance on the basis of the Qur'an and the *Sunnah* of the Prophet, peace be on him. This has resulted in an historical presentation of public finance in Islam which stands very little chance of testing its applicability at this time because of the change of the circumstances of all the Muslim states.

The second danger arises when Muslim economists consider the historical experience as binding on the present period. This results in an inability to approach the Qur'an and the *Sunnah* directly, which in turn creates an Islamic economic theory that is only historical rather than ideological.

The historical approach to the study of Islamic economics is sometimes applied with respect to present day Muslim societies. This has resulted in an Islamic economics which deals only with the problems of underdevelopment, maldistribution of wealth and income, distorted consumption, etc., rather than tackling the macroeconomic mechanism of the Islamic economic system. There is no doubt that the problems of the Muslim countries today are serious and important, and that they must be dealt with in the framework of Islamic economics, but if the Islamic economic system is a system whose subject matter is, for example, the nationalization of industry and land reform, what will happen to it after these are achieved? What will such a system do, say, for the

nationalized industry or the reformed land? The boundaries between the Islamic economic system which is applicable to a healthy economy with a normal growth on the one hand, and the emergency measures that can be taken by the economic authorities in order to deal with a temporary problem such as a war, inherent injustice of distribution, or poverty on the other hand, should be demarcated. Without such demarcation, Islamic economics becomes a partial study of transitory phenomena which will be rendered redundant after the development of the Muslim countries. This does not mean that problems such as those of development must not receive their due attention from the Islamic economists, but it means that these problems should be tackled within the framework of a general theory of the Islamic economy that preserves its relevance to all stages of economic development and political circumstances.

The diversification of modern Islamic literature on economics emerges from an inherent difficulty in this kind of study. There is no written 'Economic Theory of Islam' in the strict sense of the word. Furthermore, many may even object to the term '*The* Economic Theory' on the ground that if a theory is an interpretation of some aspect of reality, there could be a multiplicity of theories which inspire the Islamic philosophical values in interpreting economic reality. The confusion between these two different stands has led some writers to provide a very narrow version of the economic philosophy of Islam and to frame it in a very limited and restricted manner which does not conform to the theoretical implications of the values of this philosophy. (The first attempt to demarcate the boundaries between the economic philosophy of Islam and the economic theories of economic writers was made by al-Sadr in 1964.[12] He was followed by M. N. Siddiqi in 1971.[13])

A second type of difficulty is encountered not only by the research in the economics of Islam but by all studies dealing with the social aspects of Islam. It arises from the nature of the sources of Islam; the Qur'an and the *Sunnah*. Since the Qur'an is the Word of God revealed to the Prophet Muhammad, peace be on him, to be a guide for human life and behavior, the Book is not structured into parts and chapters each dealing with one aspect of human life such as Law, Politics, Economics, etc., nor is it composed of headlines or titles under which one will find the applications and rules of be-

[12]Muhammad Baqer al-Sadr. *Iqtisaduna*. Beirut: Dar al-Fikr, 1968.

[13]Muhammad Nejatullah Siddiqi. "The Economics of Islam," *Islamic Thought*, Aligarh, India, Volume 14, No. 3, 1971, pp. 22-33.

havior derived from them. It sometimes gives precise details—for example, in relation to the law of inheritance. In other cases it merely outlines the solution, suggesting the way by which Muslim scholars and thinkers can set about the task of developing and filling in the non-specified details, linking them to those injunctions which constitute an obligation and interpreting them together in order to abstract a general theory on the basis of these principles and in the light of the given circumstances. To approach and develop such theories is a duty of the Muslim scholars, and the results of their efforts cannot be attributed either to Allah or to the Qur'an. All that can be said about it is that it is an Islamic stand but not *the* Islamic stand, since the effects of their circumstances on their theorization cannot be denied. Moreover, they are not granted any authority of interpretation. In fact, no one has such a privilege. The second source, the *Sunnah*, is the Prophet's understanding and application of the Qur'an. The difficulty presented by this source stems from the fact that the Prophet was at the same time the head of state. It is therefore very difficult to distinguish between his attitudes toward those injunctions of the Qur'an which were permanent and binding for all times, and those bound by the circumstances of his time, in addition to the difficulty referred to above. The first serious attempt to theorize the complex of details from the Qur'an and the *Sunnah* in the field of economics was made in 1964, again by al-Sadr.

A last word in this section on methodology will deal with the tools of analysis. The present Islamic literature on economics has utilized two alternate methods. The first is the method of deduction and the second is the method of retrospective thinking. The first method was developed by the Islamic jurists, *al-Fuqaha'*, and is very common among them. It was applied to modern Islamic economics in order to deduce the principles of the Islamic system and its legal framework by consulting the sources of Islam, the Qur'an and the *Sunnah*. The second method has been utilized by many contemporary Muslim writers who have felt the pressure of poverty and underdevelopment in the Muslim world and have tried to find solutions for the economic problems of Muslims by reverting to the-Qur'an and the *Sunnah* in order to seek support for such solutions and to test them in the light of the Divine Guidance.

The current study makes use of both of these methods. However, it should be realized that these two methods apply basically to the study of the rules and principles of the Islamic economic system

but have little applicability to the study of macroeconomics and the general equilibrium of such an economic system, or even to the study of the theories of consumption and production, since in these areas there is need for certain kinds of mathematical analysis. Therefore the present study will apply the mathematical tools of analysis known in modern economic theory whenever it is felt to be necessary or useful. In fact, the *Fuqaha's* method is mathematical in its spirit and rigorousness.

Chapter II

THE THEORY OF CONSUMPTION

Writers with an Islamic frame of reference do not accept the contemporary formulation of consumer behavior theory on the ground that it is biased toward the ideological and social values of the non-Islamic society in which it was developed. However, they do not usually provide any substitute for it. Their objection seem to be mainly directed at the consumer values rather than at the tools of analysis, even though one could say that the different set of values may necessitate different tools. It is very common among such writers to look at the consumption theory in terms of the lawfulness of the consumer goods and services.[1] Only a few theorists have dared to tackle the basic issues in the theory of consumer behavior, such as the consumer rationalism and the concept of consumer goods.[2] This chapter follows the latter approach. Accordingly the first section will deal with the rationalism of consumer behavior, the second section will discuss the concept of goods, and the third section will explain the ethical norms of the Muslim consumer.

Islamic Rationalism

Rationalism is one of the most loosely used terms in economics, because anything can be rationalized once we refer it to some relevent set of axioms. The maximization process becomes a mere technical exercise after knowing the utility map. The determining question is concerned with the form and dimensions of this map itself, which are ethically and culturally determined and which differ in various fields of life. "Hence, rationalizations of the most

[1]See, for example, Shaikh Mahmud Ahmad, *Economics of Islam*. Lahore: Ashraf Publications, Second Edition, 1968; M.A. Mannan, *Islamic Economics. Lahore: Ashraf Publications, 1970; and Mo'tamar al-'Alam al-Islami, Qulques Aspects Economiques de l' Islam*. Karachi: 1964.

[2]See especially Muhammad Nejahullah Siddiqi. *Some Aspects of the Islamic Economy*. Delhi: Markazi Maktaba Islami, 1972, and Muhammad al-Mubarak, *Op. cit.*

varied character have existed in various departments of life and in all areas of culture."[3]

The theory of consumer behavior developed in the West after the rise of capitalism is the offspring of a duality, namely "economic rationalism" and "utilitarianism". Economic rationalism interprets human behavior as being founded on "rigorous calculation, directed with foresight and caution toward economic success."[4] Economic success is strictly defined as "making of money out of man." The acquisition of wealth, whether in terms of money or commodities, is the ultimate goal of life and at the same time the yardstick of economic success.

The ethics of this philosophy is related to and derived from "economic success." Success in money-making is the result and the expression of virtue and proficiency. Utilitarianism is the source of moral values and attitudes. "Honesty is useful because it assures credit; so are punctuality, industry, and frugality."[5]

From this dual origin emerged the theory of consumer behavior. This theory considers the maximization of utility as a postulated objective of the consumer. The utility to be maximized is that of a "*homo-economucus*" whose sole goal is to achieve the highest level of economic satisfaction and whose only stimulus is the "sense of money."

The theory of consumer behavior under the capitalist system has passed through two stages. The first stage is associated with the marginalist theory, according to which the utility of consumer is rigorously measurable in cardinal units. The consumer reaches his equilibrium when he maximizes his utility subject to an income constraint, that is, when the ratios of the marginal utilities of the various commodities equal the ratios of their money prices. The second and more modern stage rules out the measurability and the cardinality of utility. However, the conditions now become the equality between the marginal rates of substitution, i.e., the slope of the indifference curve, and the ratios of money prices, i.e., the slope of the income constraint.[6]

Muslim writers have viewed the foregoing development of rationalization and consumer theory with suspicion and have ac-

[3]Max Weber. *The Protestant Ethic and the Spirit of Capitalism*. New York: Charles Scribners' Sons, 1958, p. 26.

[4]*Ibid.*, p. 76

[5]*Ibid.*, p. 52

[6]E. Warren Shows and Robert H. Burton. *Macroeconomics*. Boston: D.C. Heath and Company, 1972, pp. 49-88.

cused it of being a limited and one-dimensional aspect of human behavior. They claim that it is based on "rigorous calculations directed with foresight and caution toward economic success," as Max Weber stated it. But they do not agree with Max Weber that the alternative to "economic rationalism" is "the hand-to-mouth existence of the peasant" or "the privileged traditionalism of the guild craftsmen."[7] Following Max Weber's proposition that rationalism is a cultural concept, Islamic rationalism is suggested as an alternative which is consistent with the Islamic values. The basic elements of this rationalism are as follows.

1. The Concept of Success

The concept of success in Islam is always associated with moral values. M.N. Siddiqi says:

> "Success lies in being virtuous. The more one's behavior is in accord with moral standards and the higher the level of his goodness, the more successful he is . . . Throughout his life, in each and every phase of existence, at every step, the Islamic individual is endeavouring to act in harmony with moral values."[8]

Virtue, in Islamic glossary, implies a positive attitude toward life and other human beings. The worst thing one can do is to withdraw from life and the community or to practice negativism toward them. It is a delicate concept which has been misrepresented by both the Sufi traditions which prevailed in the Muslim societies during the past six centuries, and by the Non-Muslim with a Christian background who looks at Islam through the lens of his life-long Christian preconceptions. Dr. Siddiqi has developed this concept further, saying:

> "Man is born with innumerable needs; to strive for their fulfillment is but natural. The more properly these needs are satisfied the better it is. A well provided life ensures peace of mind, contentment and sense of security. And it is such a state of mind which is favorable to the building of a healthy, moral and spiritual atmosphere. No level of material progress and economic development is in itself

[7]Weber, *op. cit.*, pp. 76-78.
[8]Siddiqi, *Some Aspects of the Islamic Economy*, pp. 15, 16.

antagonistic to moral and spiritual progress. As a matter of fact all such progress, if it is properly achieved and maintained, is an aid to healthy morality and true spirituality.

"Islam, therefore, does not restrict efforts at material progress. It regards a certain standard of material provision as an indispensable condition for the evolution of the desirable social pattern. It exhorts the individual to make all efforts at its achievement. It ordains society to guarantee such provision to each individual in all circumstances. But there are limits to everything. And life has aspects other than economic which call for devotion and require our energy and time for their proper development. A balanced life necessitates proper allocation of human efforts and resources among all the important aspects of life. Exclusive devotion to economic development may mean the neglect of other vital aspects of human life.

"Morality and spirituality do not demand from an enterpreneur the abandonment of his ambitions and retirement to some humble pursuit; rather it encourages and further stimulates his ambitions by calling upon him to make his enterprise, besides properly satisfying his own ambitions regarding life and its enjoyments, a means of serving humanity. Thus the statement that it is goodness and virtue which should be the center of our attention even in our economic activities does in no way mean asceticism or negation of economic ends. The way to Islamic spiritualism passes directly through the hustle and bustle of practical life. It is nothing separate and cut off from life. It is only a particular 'way' of living. And when we say that goodness and virtue should be our end we merely imply this particular way of living."[9]

Thus the pursuit of economic progress is not a vice according to Islam. In fact, it becomes one of the virtues if it is balanced and intended for a good cause.

[9] *Ibid.*, pp.17-19.

2. The Time Scale of Consumer Behavior

Islam associates belief in the Day of Judgment and the life in the Hereafter inextricably with belief in Allah. This extends the Muslim's horizon of time beyond death. Life before death and life after death are closely interrelated in a sequential manner. This has two effects as far as consumer behavior is concerned. First, the outcome of a choice of action is composed of two parts, its immediate effect in this life and its later effect in the life-to-come.[10] Therefore the utility derived from such a choice is the total of the present values of these *two* effects. Second, the number of alternative uses of one's income is increased by the inclusion of all the benefits that will be gained only in the Hereafter. Examples of such alternative uses are interest-free loans (*al-qard al-hasan*), giving to the poor and needy, care of animals, spending for the welfare of future generations, improvement of community life even when it has no immediate benefit for the individual,[11] the propagation of the message of Islam and promotion of goodness, etc. Such uses of income are excluded from Max Weber's rationalism unless they have some immediate utility. Thus, many alternative uses of one's income may have positive utility in the Islamic frame of reference, although their utility benefits in the capitalist or communist frame of reference may be zero or negative.

Furthermore, according to the Islamic teachings, every Muslim "has to expend some of his time in the remembrance of God, he has to contribute some of his energies to the propagation of truth and goodness," and has to spend of "his time and effort for the improvement of the spiritual, moral and economic life of the community."[12] This can only be done by the freeing some of man's energies from the pursuit of food and other consumables, since the other alternative, namely, withdrawal, negativism, and starvation, contradicts both human nature and the teachings of Islam. This extended time horizon implies that the *Mu'min* (Believer) should

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[10]In this regard, the Qur'an speaks of the enjoyment of the Hereafter in so many verses that any specific quotation is insufficient. However, there are several verses in the Qur'an referring to the measurability and comparability of the immediate and postponed effects. For example, verse 261 of *Surah* 2 says: "The parable of those who spend their *mal* (wealth) in the way of Allah is that of a grain; it grows seven ears, and each ear has a hundred grains. Allah gives manifold increase to whom He pleases, and Allah cares for all and He knows all things."

[11]Among the vast number of Hadiths (sayings of the Prophet) and verses of the Qur'an, one is impressed and amazed at the stress on effort and striving in order to meet one's responsibilities and improve the life of the community.

[12]Siddiqi, *Some Aspects of the Islamic Economy*, pp. 19-20.

not limit himself to doing those things whose benefits he can reap in this life. He is so oriented that he will do what is good or useful for its own sake, or, to express it in Islamic terms, because Allah will reward him for it. In this respect, the Prophet, peace be on him, is reported as having said, "If one sees the end of the world coming while he has in his hand a little plant and he is able to plant it in the ground, he should do it. Allah will reward him."[13] The law of inheritance in Islam supports this extended vision by granting the full claim of one's heirs on one's estate. The Prophet is reported, in this context, to have recommended leaving one's heirs rich rather than poor.[14] True success for the Muslim is that which embraces, the total horizon of time, for it is the same effort to do good which results in success both in this life, in all its aspects, and in the life after death. The Qur'an unequivocally emphasizes this behavioral norm for material and spiritual matters alike in order to secure a balanced life. It says:

> "Corruption has appeared on land and sea because of (the evil) which men's hands have done, that He [Allah] may make them taste a part of that which they have done, in order that they may turn back (from evil). Say [O Muhammad to the disbelievers]: Travel through the earth and see the nature of the consequence for those who were before you. Most of them were idolators. . . . Whoso disbelieves must bear the consequences of his disbelief, while those who do right make provision for themselves."[15]

> "But if there comes to you guidance from Me, then whoever follows My guidance will not go astray nor come to grief. But he who turns away from remembrance of Me, his will be a narrow life . . ."[16]

> "And I have said: 'Seek pardon of your Lord. Indeed He is ever-Forgiving. He will send rain to you in abundance, and will help you with wealth and sons, and will bestow upon you gardens will bestow upon you rivers."[17]

[13]Hassan al-Banna. *Majmu'at Rasa'il al-Imam al-Shahid*. Beirut: Dar al-Andalus, 1965, p. 15.
[14]Al-Siba'i, *op. cit.*, p. 303.
[15]30:41-42, 44.
[16]20:123-124.
[17]71:10-12.

3. The Concept of Wealth

Islam sees wealth is a bounty from God. Al-Siba'i argues that Islam disapproves of poverty, referring to the saying of the Prophet, peace be on him, "Poverty is almost equivalent to denying Islam."[18] The Prophet used to pray:

> "Almighty God, protect me and help me to avoid incapability and laziness, fear and avarice; protect me and help me to avoid poverty, disbelief and misbehavior". "O God, I request You to guide me on the path to You, to give me love and fear of You, to make me satisfied with what You give me, and to me give richness."

Al-Siba'i comments concerning the last part of the Prophet's prayer that it indicates a positive attitude towards wealth and not merely a negative stand on poverty.[19]

While avarice is an evil, so is extravagance. The *Mu'min* is described in the Qur'an as one of "those who, when they spend, are not extravagent and not miserly, but (maintain) a just balance between those (extremes)."[20] The Prophet is reported as saying, "God likes to have His servant showing the signs of the bounties He gave to him in his life (in terms of prosperity and spending)." However, where spending for charity, on the improvement of the conditions of living of the community and for the propagation of the message of Islam is concerned, the concept of extravagance does not apply. There is no upper limit to this kind of spending and every bit of it will be rewarded by God.

The spirit of Islam in respect to wealth and spending is summarized in the following two sayings of the Prophet, peace be on him:

> "The Prophet once asked some of his Companions: To which one of you is the wealth of his heir dearer than his own? They answered: Every one sees his own wealth as dearer than his heir's. Then the Prophet said: Your wealth is what you use and your heir's is what you don't."[21]

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[18] Al-Siba'i, *op. cit.*, p. 132.
[19] *Ibid.*
[20] 25:67.
[21] Al-Siba'i, *op. cit.*, p. 301.

> "None of your property (wealth and income) belongs to you except what you eat and use up, what you wear and wear out, and what you spend on charity, the reward of which is saved for you." (Reported by Muslim and Ahmad.)[22]

These are the components of the rationale of the *Mu'min's* behavior. The study of economics shows that the assumption of mere materialistic motivation is unrealistic. However, the non-material factors may be arbitrarily left out of economic analysis for the purpose of isolating economic phenomena. Yet while this may simplify the matter for purposes of study, the non-material factors must be reintegrated in some higher stage of the analysis.

Taking these factors into account, the maximization proposition becomes indisputable from the point of view of Islamic thinking.[23] The maximization proposition may even be used as a generalized scheme for life as a whole, i.e., "Whenever anything is good one should do as much of it as he can."[24] That is the best, but if this is not possible, the next best alternative is expressed by the well-known rule of Islamic thought that one should sacrifice the lesser good if this is the only way to achieve the greater good. Or to express it in the negative manner, one is permitted to do something that is wrong if it is the only way to avoid what is worse.[25] This point will be discussed later.

The Islamic Concept of 'Goods'

In the Islamic frame of reference, goods are bounties bestowed by God on mankind. A survey of the Qur'an provides us with a unique concept of products or commodities. The Qur'an always refers to consumable goods by using terms which attribute moral and ideological values to them. Two terms used in the Qur'an in this respect are (1) *al-tayibat* (الطيبات) and (2) *al-rizq* (الرزق).

The first term, *al-tayibat*, is repeated eighteen times in the Qur'an.[26] In translating this term into English, Yusuf 'Ali has inter-

[22] Ibn Kathir, *Tafsir al-Qur'an al-Adheem* Beirut: Dar al-Andalus, 1971, p. 549.

[23] Muhammad Nejatullah Siddiqi. *The Economic Enterprise in Islam.* Lahore: Islamic Publications, 1972, p. 90.

[24] Ali Abdul-Rasul, *Al-Mabadi' Al-Iqtisadiyah fil Islam. Cairo: Dar al-Fikr al-Arabi, 1968, p. 66.*

[25] *Ibid.*, 1 pp.84-85.

[26] Since the term means good and pure things, its derivatives are, in fact, repeated in the Qur'an forty-three times. But they are used in respect to goodness and purity in general without specific reference to consumable materials.

changeably used five different phrases to express the ethical and spiritual values of the term. According to him, *at-tayibat* means: "good things," "good and pure things," "clean and pure things," "good and wholesome things," and "sustenance of the best."[27] Thus, consumer goods are intimately tied up with values in Islam, denoting the values of goodness, purity and wholesomeness. In contrast, bad, impure and worthless objects cannot be used nor considered as consumer goods in Islam.[28]

The second term, *ar-rizq*, and its derivatives are repeated in the Qur'an, one-hundred-and-twenty times. In Yusuf 'Ali's translation of the Qur'an *ar-arizq* is used to denote the following meanings: "Godly sustenance," "Divine bestowal," "Godly provision," and "heavenly gifts."[29] All these meanings convey the connotation that Allah is the true Sustainer of and provider for all creatures.

Consequently, in the Islamic concept, consumer goods are the useful, beneficial consumable materials whose utilization brings about the material, moral and spiritual betterment of the consumer. Things that do not have any goodness and do not help improve human beings are not goods according to the Islamic concept, nor can they be considered as the property or assets of Muslims. Accordingly, prohibited materials are not considered as goods in Islam.[30]

Let us compare this Islamic concept of consumer goods with the God-less concept of utility prevailing in modern economics. While in modern economics anything has economic utility if it can be exchanged in the market, in Islam this is a necessary but not sufficient condition for the definition of goods. Goods must be morally useful as well as exchangeable in the market in order to possess economic utility.

The Ethics of Consumption in Islam

According to Islam, Allah's bounties belong to all mankind and the mere circumstance that some of these bounties may be under

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[27] *Abdullah Yusuf 'Ali. The Translation of the Holy Qur'an.* Washington, D.C.: The Muslim Students' Association of the United States and Canada, 1975, pp. 31, 231, 241, 348 and 508.

[28] *Ibid.*, pp. 178, 274, 424.

[29] *Ibid.*, pp. 21, 675, 676, 819, 867, 903 and 1018.

[30] Consequently, such things as alcoholic beverages, pork and its products, and images or statues are not the object of the right of ownership and cannot be transacted in the Islamic economy. See, for example, Muhammad Ben Isma'il al-Amir al-San'ani (died 1182A.H.). *Al-'Uddah Sharh al-'Umdah.* Cairo: al-Matba'ah al-Salafiyah, 1379A.H., V. 4, pp. 83-85.

the authority of particular people does not mean that they can utilize them for themselves alone; others who do not happen to have at their disposal that much of what God has given to mankind still deserve their share even though they did not earn it. In al-Qur'an Allah Ta'ala condemns and repudiates the argument that is given by the miserly rich man for not giving the poor his due share:

> "And when they are told, 'Spend of (the bounties) with which Allah has provided you,' the Unbelievers say to those who believe: 'Shall we then feed those whom, if Allah had so willed, He would have fed (Himself)? You are in nothing but manifest error."[31]

Furthermore, the act of use or consumption of good things is in itself considered as a virtue in Islam, since the enjoyment of what Allah creates for mankind is obedience to Him Who said to the parents of mankind, Adam and Eve, as narrated in the Qur'an, ". . . and eat of the bountiful things therein as you will . . .,"[32] and Who enjoined on all human beings, "O people, eat of what is on earth, lawful and good."[33] Therefore, a Believer seeks the pleasure of God by obeying His orders and enjoying himself with the goods and bounties created for mankind. Consumption and satisfaction are not condemned in Islam as long as they do not involve any harm or harmful things. Allah Ta'ala says in the Qur'an "Say: Who has forbidden the beautiful (gifts) of God which He has produced for His servants and the things, clean and pure, (which He has provided) for sustenance?"[34]

Overconsumption, which is a characteristic of the Godless society, is condemned in Islam and is termed *israf* (extravagance) or *tabthīr'* (profligacy). Profligacy means spending in the wrong way, that is, for prohibited purposes such as bribery or for illegal things or in a reckless manner.[35] Each of these categories includes several types of spending which have become almost phenomenal in the consumer-oriented society. Extravagance means overspending on lawful matters such as food, clothes, shelter or even charity. The Islamic teachings recommend a moderate and balanced pattern of consumption and spending, a pattern which lies inbetween miser-

[31] 36:47.
[32] 2:35.
[33] 2:168.
[34] 7:32.
[35] For the definition of profligacy (تبذير) see *Tafsīr Ibn Kathīr*, *op. cit.*, Vol. III, pp. 36-37.

liness and extravagance.[36] Consumption above and beyond the moderate level is considered *israf* and is condemned.[37]

An important characteristic of Islam is that it not only changes the values and habits of people but also provides the necessary legislative framework to support and sustain these ideals and prevent their misuse. This feature of Islam also has its applicability to the case of the extravagant or the profligate. In Islamic jurisprudence, such a person would be restricted and, when appropriate, precluded and debarred from administering his own properties. In the eyes of the *Shari'ah* (Islamic law) he would be treated as a minor and someone else would be assigned to administer his property on his behalf.[38]

[36] 17:29
[37] 6:141
[38] Al-Mubarak, *Op. cit.*, p. 87.

Chapter III

THE THEORY OF PRODUCTION

Production can be viewed from two aspects: the positive study of the material and economic laws which shape the production function, and the normative study which deals with the stimuli and goals of production. The first is the concern of positive economists and engineers, while social theorists deal with production from the latter point of view.

This chapter consists of four sections. The first and second sections discuss the motives and goals of production respectively; these two sections will concentrate on the ideological position of Islam in relation to production as a whole. The third section analyses the objectives of the production unit, the firm, while the fourth section will focus on the problem of the factors of production.

Motives of Production

The extraction of every particle of usefulness from the entire universe is an ideological objective of the Islamic society.[1] It is evident that this is a religious obligation of man on earth and it is derived directly from the Islamic view of man and the universe.[2] Islam approaches this goal by two means, ethical teachings and legislation.

The modern Islamic literature on economics gives a quite good survey of the texts from the two sources of Islam, the *Qur'an* and the *Sunnah*, which make clear the Islamic ethics concerning the importance of production, the prohibition of abstention from production even for the sake of extra worship or meditation, and the prevention of laziness and idleness.[3]

[1] Al-Sadr, *Iqtisaduna*, p. 573.

[2] *Ibid.*, pp. 572-3, and Hassan al-Banna, *op. cit.*, p. 394.

[3] Al-Sadr, *op. cit.*, pp. 573-6, Muhammad al-Mubarak, *op. cit.*, pp. 22-26; and Yusuf al-Qardawi. *Mushkilat al-Faqr*. Beirut: Dar al-'Arabiyah, 1966, pp. 17-29.

The legislative means taken by Islam to promote productivity and discourage idleness or non-utilization of resources will become clear in a summary of twenty clauses given by al-Sadr as examples.[4]

1. The government will take land away from the private owner if he does not till it and abstains from cultivating and using it. The state will not pay any compensation and will dispose of the land to the best of its judgment.
2. Acquisition of ownerless land does not establish the right to ownership of it; what does is the proper utilization of it. Colonization of land is a source of ownership in Islam under four conditions:
   i. Non-existence of any previous claim of ownership.
   ii. Continuous productive use of it.
   iii. The non-use of others' labor, even if it is paid for in the process of colonization.
   iv. The non-violation of the principle of equal opportunity.
3. No privately-owned natural resources are to be left unused. Non-use of them results in the invalidation of the private claim on them.
4. Public land may be given to private bodies only in accordance with their capability of utilization.
5. All kinds of non-productive intermediary activities are prohibited, such as leasing a piece of land at certain rate and renting it at a higher rate.
6. Interest is prohibited as being a guaranteed source of income to those who are not actually involved in the productive activity.[5]
7. Economically non-productive activities such as gambling, or the practice of magic, or sorcery are prohibited.
8. Hoarding of money or other mobile assets is discouraged by the imposition of a 2.5% yearly tax on it.
9. The use of alcohol, drugs, and all means of wantonness which affect the sensibility of a person and his ability to carry on serious productive activities are prohibited.
10. Legislation which leads to continuous and slow fragmentation of concentrated wealth is to be enacted.
11. Speculation is restricted and mere speculative transactions in

[4]Al-Sadr, *op. cit.*, pp. 576-86.

[5]See Chapter V for a detailed study of this point.

both the finance market and the commodity market are prohibited.

12. Inheritance laws are to be used as a stimulus to productive activities, and at the same time the inability imposed by Islam on anyone to select his own legal heirs or reduce their number is a means toward attacking the concentration of wealth.
13. There is to be social insurance in relation to both the guaranteed standard of living and the guaranteed payment of debts.
14. Unwillingness to work and voluntary idleness makes an individual ineligible for social insurance.
15. The discouragement of luxury in private consumption makes investment-biased spending more attractive.
16. It is a collective duty[6] of the Islamic community to make available every useful branch of knowledge and industry.
17. It is the collective duty of members of the Islamic community to participate in the leading industries and fields of knowledge in the world.
18. The state has a leading role to play in production in relation to planning and public enterprise.
19. The state is allowed to obtain resources and redistribute them in order to maximize the realization of the normative objectives of the society.
20. The state enters the field of economic activity as a central planner and supervisor.

Objectives of Production

Modern Islamic literature on ecomonics is emphatic in viewing production as man's effort to improve not only his material condition but also his morals and as a means of attaining his goal in the Hereafter. This has three important implications:

First, products which deprive the human being of his moral values as established in the Qur'an, are prohibited. Also prohibited are all types of industrial activity and relations which degrade the human being or make him party to vices for the sake of economic gain. Thus the Prophet, peace be on him, prohibited certain forms of economic activity such as prostitution and the income generated by it.[7]

[6]'Collective duty' has a special meaning in Islamic jurisprudence. It is an individual obligation on every member of the community until the point at which satisfactory work is done and maintained; then it ceases to be so and becomes an individual duty only on those who are in the field. It is the duty of the state to move the community toward the satisfactory level.

Second, the social aspect of production is emphasized and intimately related to the production process. Actually the distribution of the benefits of production among the greatest number of people and in the most equitable manner is the prime economic objective of the society. The Islamic economic system is committed to the welfare of the people to a far greater degree than the existing or traditional types of capitalism.[8]

Third, the economic problem is not one of scarcity in relation to needs but is caused by human laziness and neglect in the extraction of the full benefits of Allah's gifts in terms of both human and natural resources. This laziness and neglect is called 'oppression' or 'cruelty' in the Qur'an.[9] A *Hadith* of the Prophet reports him as admonishing, "Ask Allah to help you and do not feel incapable, for nothing is impossible."[10]

The foregoing discussion remains at the macro-level. Two further aspects of the theory of production are tackled within the Islamic literature: the goals of the firm and the factors of production.

The Goals of the Firm

Maximization of utility is the goal of the firm in the Islamic economy; this is understood in the light of the Islamic rationalism detailed in Chapter II of this book. Utility in the present sense includes both that of the enterpreneur and of the owner of capital. In this respect management cannot, for example, give up part of the firm's income for charitable purposes (in excess of the minimum obligatory level, which will be discussed in Chapter IV) without the prior permission of the other partners.

M.N. Siddiqi in his 1972 book mentions several goals of the economic enterprise in Islam, which are:[11]

1. the fulfillment of one's own needs in moderation;
2. meeting the needs of one's family;
3. provision for future contingencies;
4. provision for posterity;
5. social service and contribution to the cause of Allah.

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[7]Ibn Daqiq al-Eid (died 702A.H.) *Sharh Umdat al-'Ahkam* Cairo: -Matba'a as-Salafiyah, 1379 A.H., Vol. 4, pp. 66-70.

[8]Al-Sadr, *op. cit.*, pp. 589-93.

[9]14:32-34.

[10]Reported by Imām Muslim.

[11]Siddiqi, *The Economic Enterprise in Islam*, pp. 11-34.

He supported each of these objectives by narrating numerous texts of the Qur'an and the *Sunnah*. The mention of so many Islamic injunctions which motivate economic behavior is of great interest, but these objectives are also to be the goal of any individual economic activity and not only of the firm. Hence, these ends are too general and some index of the collective utility of the firm is suggested to replace them.[12] The proposition of profit maximization should be modified since as it stands in the capitalist system, it does not fit the Islamic rationale in relation to the time horizon and the connotation of 'success.' To simplify an understanding of the goals of the firm in the Islamic economy, profit maximization can be used as a fair criterion if we look at it as constrained not only by cost but also by a minimum level of good guaranteed both by ethical values and legislation. Within this context, the process of maximizing profit on behalf of the firm should not violate 'the rules of the game' of the Islamic economy.[13]

Two main differences can be noticed in this respect between the constraints on business behavior in a capitalist society and in an Islamic society: first, the degree of interference of law is indisputably greater in the Islamic society, and second, the lack of any effective control on non-legislated ethics in a capitalistic society as compared with the *Hisba* Agency in the Islamic society.

Factors of Production

There is no agreement in modern Islamic literature concerning the factors of production. Abu Sa'ud, for example, goes along with any intermediate level microeconomics textbook in the West to classify factors of production as land, labor and capital, whereas Abdul-Mannan excludes capital from this list. The divergence arises from either of the following two problems: the confusion between the ultimate factors and the immediate factors, or whether we consider capital as accumulated labor. This is intensified by the failure to reconcile the prohibition of interest in Islam with the obvious role capital plays in production. This failure is due to the existence of the capitalist preconception that interest is the price of capital which is at the back of the minds of some writers. Dealing with the first problem carries us into the heart of the value theory, and dealing with the second introduces us to the distribution theory.

[12]See Chapter V.
[13]See Chapter IV.

1. **Capital as Accumulated Labor**

Capital is stored labor embodied in a commodity and used in the process of producing other commodities.[14] Understood in this way, labor is the only factor of production which deals in economic terms with the gift of Allah, the natural resources, to create value. As a matter of fact, Muslim writers are more interested in the 'claim of ownership' than 'value' as a result of the economic labor applied to nature. Economic labor is defined as the labor applied to nature in order to extract the consumer's utility or create a productive opportunity from the natural resource.[15] It does not include acquisition or monopolization of land on the basis of power. Such labor is not economic since acquisition by itself does not produce utility but is, at best, a private opportunity to produce utility which was already available.

a. Economic labor is of two kinds. First, there is the mere acquisition of mobile resources. The simple labor of taking water from the river in a private pail creates the claim of ownership on the water in the pail even before making use of it. Second, there is the creation of productive opportunity, which in the Islamic literature is called *Ihya'*, refers to creating life in the land. In this respect acquisition alone is not sufficient.

b. Up to now we have been discussing a labor theory of value which does not deviate from the classical or Marxist line of thought. The deviation begins when we deal with the object to which the labor is applied. The claim of ownership is only on the opportunity created and not on the natural resource itself. A few examples may clarify this concept:

   i. A person who creates life in a piece of non-cultivated land owns the productive capacity created by his labor. He can lease the result of his labor for agreed-upon rent. Once he neglects the land and it goes out of economic use, he loses his claim on it.

   ii. A person who applies his labor and seeds to a piece land which is already in economic use has a claim on the output but not on the land, and he is required to compensate the owner for the use of the land.

   iii. A person who digs a well has a private claim on that part of water which meets his needs, and if there is

[14]Mahmud Abu Sa'ud, *Khututun Ra'iyah fi'l Iqtisad al-Islam*, Beirut: Matba'at Ma'tuq Ikhwan, 1965, p. 55, and al-Sadr, *op. cit.*, p. 547.

[15]Al-Sadr, *ibid.*, p. 573.

extra water he has to give it free because his claim is not on the well but only on the use of its water. The difference between the use of a well and the use of land is that in the case of land a second person cannot extract extra utility from it without competing with the 'source of life' in it. This would be an infringement on the other's right, but in the case of a well the second user will not affect the quantity of water extracted by the first.

In summary, the claim of ownership is only on the opportunity created and within its limits. Once an opportunity is created further labor cannot compete with the earlier one. Thus, the share of such new labor is the extra opportunity which it adds. Islamic economics does not assume any correspondence between the exchange value and the amount of labor applied for the two primary reasons: First, the same amount of labor may create a variety of opportunities, depending on the natural resources dealt with, i.e., it is assumed that the natural resources are not deprived of any exchange value. It is on this basis that *al-Tasq*, a special tax on a newly created opportunity, is justified. Second, the demand has, generally speaking, an equal role in the determination of exchange value, as we shall see in Chapter IV.

c. The second difference between the Islamic and Marxist views on the subject is that the Islamic theory not only distinguishes between exchange value and labor but also between exchange value and the claim of ownership on output. According to the Islamic economic theory, the claim of ownership on the product is shared between the labor that created the opportunity of extracting benefit and the society that exercises its right of controlling the natural resources. Thus, although there are elements other than labor entering into the composition of exchange value, they have no claim on the product. As a matter of principle, the tools of production, unless they enter into exchange value, do not have a claim on the output. While in the Marxist analysis the claim of ownership on the product belongs to the stored and current labor which shared in the creation of the exchange value, the separation between exchange value and the claim on the output does not imply that the owners of 'stored labor' are deprived of their claim on it. This is

organized in Islam by what is referred to in the literature as 'the principle of constancy of ownership.' This means that the earliest claim of ownership remains valid and the latest labor applied on the same object deserves only a fair remuneration. According to this principle, the relations of hiring-renting are justified on both sides. The owner of materials (whether he is at the same time the one who provides labor, as in some agricultural contracts) who provides capital or land can hire the lacking elements which may be in the form of either direct or stored labor working for a remuneration which is looked at as a personal claim on him rather than a claim on the output.

2. **What is the Price of Capital?**

The first answer to this preliminary question which comes to mind is: interest. This is the answer which can be obtained from almost every intermediate textbook on economics. However, little reflection on the elementary concepts in economic theory will change the reply to the above question.

Let us begin by defining the terminology in order to get rid of the confusion created by jargon. Capital is defined as meaning "only the accumulated stock of plant and equipment held by business."[16] It consists of durable goods which are used in producing other goods and services. This definition does not fit with the use of the term in the usual jargon, in which capital is meant to include money which can be borrowed in the finance market, which is then called the capital market. But the fact that money can buy machinery does not imply that both are the same because money can also buy any other goods, whether used in production, such as land or labor, or in consumption, such as food or clothes. This distinction between loan and capital leads to the parallel distinction between their remuneration. The price of capital, assuming homogeniety or the existence of common index, is rent per machine, and the price of loan is the rate of interest per unit of loan. This distinction can be easily understood if we look at the interest rate through the Fisher-Patinkin-Hansen notation as the percentage difference in real prices between t_1 and t_2, i.e., $\frac{p_2 - p_1}{p_1}$.

Thus we do not need to downgrade the role of capital goods in production, as Abdul Mannan did,[17] in order to justify the prohibi-

[16]Edward Shapero. *Macroeconomic Analysis.* New York, Harcourt, Brace and World, Second Edition, 1970, p. 202.

[17]Mannan, *op. cit.*, p. 126.

tion of interest in Islam.[18] In this respect, capital which participates in production has its reward, which is a personal claim on the owner of the material, whoever he is.

3. **Corollary: The Right of Ownership.**

From the preceding discussion, it will presumably have become evident that the right of ownership is defined in a special way in Islamic literature. Hence, a brief reference will be made to the characteristics of the right of property as understood in Islamic economics.

i. Property is a trust, the true owner being Allah Ta'ala Himself. Man's right to dispose of wordly goods is in the capacity of a vicegerent and a trustee. By definition, his rights are circumscribed by the limits which Allah has prescribed and which are to be exercised toward the ends He has defined. Such obligations as Allah has made to devolve on these rights should be sincerely fulfilled. The right to property is, therefore, not absolute but limited and qualified.

ii. Even the limited rights of ownership can neither be devoid of purpose nor an end in themselves, in view of the purposive nature of man's life. Wealth is a means to the end of living a life in accordance with Allah's guidance and of earning the reward in the Hereafter. It should be instrumental in the effective discharge of man's responsibilities as the vicegerent of Allah, and in the achievement of well-being in this life as well as in the Hereafer.

iii. The purposive nature of property rights coupled with the idea of the oneness of mankind requires that the bounties of nature and worldly goods be accessible to all men, that they do not become the monopoly of the few. As all human beings are members of one family, man should handle the wealth bestowed upon the family of mankind as a whole as the members of an individual family do.[19]

iv. The object of the right of property is the opportunity of economic utilization. If this opportunity is not attended to or the utilization is diverted to non-economic purposes as defined earlier, the right will be reduced (to the limit of zero) in proportion to the 'oppression' committed. This may mean foregoing the entire right in case of losing the opportunity, or the deprivation of control over one's property in case of misuse.

[18]This will be considered in Chapter V.

[19]Siddiqi, *Some Aspects of the Islamic Economy*, pp. 49-52.

v. This does not mean that Islamic economics looks at private ownership as a right granted by society; rather it is intimately related to the principle that man is the trustee of God. Property is granted by God, as stated in the Qur'an, but it is a conditional grant. This means that the owner should not commit any 'oppression' with it or because of it, i.e., he should not violate these conditions. It also implies that there should be no excessive penalty for the violation, as is laid down in the well-known precept, "There should be no harm, neither injury."[20] It is on this basis that social welfare contributions are collected by the power of law in Islam.[21]

vi. The right of ownership is limited in time by the life of the owner. The owner does not have any authority over his wealth after his death. Thus the inheritance law of the Qur'an gives details concerning the distribution of the estate and considers death as a natural end of one's property rights. This restriction is completely in keeping with Islamic conception of the right of property, which is more of a limited vicegerency rather than an absolute claim.

[20] Al-Mubarak, *op. cit.*, pp. 76-86, and M.N. Siddiqi, *The Economic Enterprise*, pp. 44-51.

[21] Al-Siba'i, *op. cit.*, pp. 200-211.

Chapter IV

MARKET STRUCTURE: FREE CO-OPERATION

According to the classical theory of perfect competition, the market is composed of an indefinite number of small producers and small consumers. Freedom of entry and exit, and freedom of choice of technology and methods of production as well as freedom and availability of information, are all guaranteed by the government. In such a market, it is asserted, the most efficient technology will be able to survive. Division of labor assures maximum utilization of resources and every factor of production is rewarded according to its marginal productivity, while prices are set at the lowest possible level by the free working of the market forces.[1]

This system of free enterprise has failed to sustain the socialist attacks accusing it of responding only to price signals and entitling the owner of the means of production, the capitalist, to make decisions harmful to the interest of the working class, the prolitariat. Thus the capitalist, in pursuing his own interests, suppresses the wage rate to subsistence level, and in seeking to fight against an ever-declining rate of profit, concentrates wealth in a few hands. Internal contradictions among the interests of classes lead to the prolitarian revolution and dictatorship.[2] The free enterprise system could not withstand the attempts of reformers. As early as the thirties, Chamberlin challenged its freedom of entry and exit and the claim that individual producers are unable to quote the market prices. His theory of "Monopolistic Competition,"[3] taken together with the economic history of the United States during the last

[1]See, for example, Paul A. Samuelson, *Op. cit.*

[2]Karl Marx. "Introduction to the Critique of Political Economy," in *Marx and Modern Economics*, edited by David Horowitz. N.Y.: Modern Reader Paperbacks, 1968, pp. 21-48.

[3]Edward H. Chamberlin. *The Theory of Monopolistic Competition*, Cambridge, Mass.: Harvard University Press, 1933.

three-quarters of a century, shows unequivocally that government interference in the economy has been made unavoidable by the failure of the functioning of the free enterprise system. Furthermore, the free enterprise system has brought about instability in economic activities and business cycles. The dichotomy between the decision to allocate income and the decision to invest, and the failure of notional demand (i.e., the demand of the unemployed if he is employed and given income) to produce any market signals, has raised many questions about the validity of the system,[4] and has led Keynes to argue for the case of deliberate public spending and public works.[5] On the other hand, the failure of economic freedom to provide for a free flow of information creates market frictions and raises doubts about the very foundations of the free enterprise system.[6]

The success of the communist revolution in the Soviet Union brought into reality another proposition for resource allocation. The answer to the basic questions of how, what and for whom is now given by the central planning board, the Gosplan. Resources are allocated, goods are produced and prices are set up according to social priorities established by the political leadership of the revolution. Although economists have tried hard to demonstrate that such choices do not actually represent the optimum welfare of the society,[7] social preferences are always pronounced by revolutionary governments in a large part of the world.

The central planning system of the market structure has given more economic weight to bureacracy and has led to several setbacks, especially in agriculture and the consumer goods industries.

This chapter will survey the Islamic approach to the market structure. The title "Free Cooperation," was intended to reveal the two main themes of this system, namely freedom and the spirit of cooperation. Thus, the first two sections of this chapter will deal with these two aspects. The third section will study the role of the government as a permanent agent in the Islamic market, and the fourth and last section will throw more light on the spirit of cooperation by studying 'the rules of the game' in the Islamic market.

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[4]Axel Leijonhuvfud: *On Keynesian Economics and the Economics*. New York: Oxford University Press, 1968.

[5]John Maynard Keynes. *The General Theory of Employment, Interest and Money*, N.Y.: Harbinger Books, 1964.

[6]Mabid Mahmūd: "Frictions, Power Rationing and *Al-Zakat*" in *Proceedings of the Third National Seminar*, Assn. of Muslim Social Scientists, Gary, Ind.: 1974, pp. 29-44.

[7]See, for example: Jerome Rotherberg. *The Measurement of Social Welfare*. New Jersey: Prentice Hall, 1961, pp. 17-60.

Economic Freedom

Economic freedom is the first pillar in the structure of the Islamic market. This freedom is based on the fundamental teachings of Islam, as will be evident from what follows.

1. Responsibility and Freedom

The principle of individual responsibility is so basic to the teachings of Islam that it is emphasized in innumerable verses of the Qur'an and in numerous reports of the actions and sayings of the Prophet, peace be on him. This principle of individual responsibility is mentioned in many different contexts and occasions in the Islamic sources.[8]

a. Everyone will be judged singly alone on the Day of Judgment, and this applies even to the Prophets and their dearest relations. There is no way one can atone for his misdeeds except by seeking Allah's forgiveness and doing good deeds.[9]

b. There is no concept of Original Sin, no one is responsible for other's mistakes, and there is no baptism and no chosen people.[10]

c. Every individual has a direct relationship with Allah., There are no intermedaries.[11] The Prophet, peace be on him, himself is only a Messenger or a vehicle through whom Allah's guidance has been revealed to mankind. Forgiveness must be asked directly from God. No one has the least authority to give his decision on His behalf. It is against the spirit of Islam to make any 'confession' before any religious authority.[12]

d. Every individual has the full right to consult the sources of Islam (the-Qur'an and the-*Sunnah*) for himself. He should exercise this right, for it is a cornerstone in the carrying out of one's responsibility to God. Learning is a rational process, and it cannot be acquired through spiritual practices or medita-

[8]Allah Ta'ala says in the Qur'an ". . .that man can have nothing but what he strives for; that (the fruits of) his striving will soon come in sight; then will he be rewarded with a reward complete." (53:39-41).

[9]"And everyone of them will come to Him singly on the Day of Judgment." (19:95).

[10]". . .No bearer of burdens can bear the burden of another." (53:38)

[11]"When My servants ask thee concerning Me, I am indeed close (to them). I listen to the prayer of every suppliant when he calls on Me. Let them also, with a will, listen to My call and believe in Me, that they may walk in the right way." (2:186).

[12]God tells His messenger Mohammad in the Qur'an: "Not for thee (but for God) is the decision whether He turn in mercy to them or punish them, for they are indeed wrongdoers." (3:128).

tion. Teaching religion is a scientific procedure which does not carry with it any suggestion of special privilege or authority for the learned.

e. Islam was completed with the end of the revelation to Phrophet Mahammed, peace be on him, with his death.[13] None can add, omit or change even one statement. Every deduction from or interpretation or application of a text of the Qur'an or the *Sunnah* is only a personal understanding in which people may differ, and none of them can impose his understanding upon others.

This full account of a Muslim's responsibility is necessarily based on a wide range of freedom, beginning with the freedom to choose one's belief and ending with the most negligible decision one may make. Since freedom is the twin of responsibility, the more the latter is emphasized, the more stress there must be at the same time on the former.

2. The History of Economic Freedom in the Muslim Society

Throughout the history of the Muslim society, economic freedom has been guaranteed by the traditions of the society as well as by the legal system. The Prophet, peace be on him, refused to fix prices even when they rose very high. His refusal was based on the principle of fair-dealing in business which does not allow for forcing the producers to sell their goods at lower than the market price as long as changes in prices are caused by the real factors of supply and demand without any monopolic or monopsonic forces.[14] Furthermore, the Prophet peace be on him was keen to minimize the information gap in the market when he rejected the idea of receiving farmer-producers before they reached the market place and became familiar with what was going on there.[15] He was very forceful in dealing with cheating and monopoly, to the extent that he equated them with the worst sins and disbelief.[16]

After the Prophet, peace be on him, and throughout the many centuries of the Islamic history, the Muslim society has preserved

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[13]God says in the Qur'an: "This day have I perfected your religion for you, completed My favour upon you and have chosen for you Islam as your religion." (5:4).

[14]Ahmad Ibn Taymiyah. *Al-Hisba fil-Islam*, Beirut: Dār al-Kutub al-'Arabiyah, 1976.

[15]*Ibid.*

[16]Abdul-Rasul, *op. cit.*, pp. 16-18.

this cherished principle of freedom. The concept of controlling the moral behavior of the market was introduced by the Prophet himself. During the early centuries of the Islamic time, various thinkers wrote books on the role and duties of the market controller, *al-Muhtasib*. The theme that prevails all these writings is the preservation of freedom in the market and the elimination of the monopolistic elements.[17] The principle of freedom was carried by many Muslim jurists to an extent which even threatened the system by depriving the government of its right to interfere in the case of monopoly. This, indeed, compelled Ibn Taymiyah to write his book, *Al-Hisba fil-Islam*, to show that individual economic freedom must be limited in such cases, even if such limitations include the pricing of goods and services.[18]

With this background, in order to express his definition of economic freedom, Ibn Taymiyah could confidently make a strongly-worded-statement that individuals are fully authorized to keep their property, and that no one has any right to take all or part of it without their free agreement, except in some clearly-specified cases in which they are obliged to give it up.[19]

Maulana Abul-A'la-Maududi states that in the view of Islam, it is the individual who is important and not the community, society or nation. The individual, he argues, is not meant to serve society, it is society which should ultimately serve the individual. No community or nation is responsible before Allah as a group; each member is responsible before Him individually. The free and ultimate reason for the existence of the social system is the individual's welfare and happiness, and not that of the society. Hence the true measure of a good social system is the extent to which it helps its individual members to develop their personalities and to improve their personal abilities and capabilities. Based on this, Islam disapproves of any type of social organization and any social welfare scheme if it suppresses individuals and ties them very strongly to the social regime, so that their independent personalities perish, and the majority of them become mere machines or tools in the hands of a few others.[20]

In *The Economic Enterprise in Islam*, M.N. Siddiqi declares that

[17]Monzer Kahf. "The Economic Views of Ibn Taymiyah," unpublished paper, 1976.

[18]Ibn Taymiyah, *op. cit.*

[19]Kahf, *op. cit.*, pp. 12-13 and 17-18.

[20]Abul-A'la-Maududi: *Usus al-Iqtisad bayn al-Islam wan-Nuzum al-Mu'asirah*. Lahore: Dar ul-Uruba, 1955, pp. 130-131. Also, Muhammad al-Mubarak, *op. cit.*, p. 107.

Islam relies upon the market mechanism up to a very great extent.[21] Some implications of the doctrine of economic freedom in Islam in relation to the market are found among Ibn Taymiyah's views. These are:

1. People are free to enter and to leave the market.
2. An adequate level of information about the market forces and commodities is necessary. Ibn Taymiyah investigated contracts in which one of the parties did not comply with this condition, whereupon he gave the other party the option to revise the contract. He also saw it as the responsibility of the government (*al-Muhtasib*) to rectify the situation.
3. Monopolistic elements should be eliminated from the market. Ibn Taymiyah did not permit coalitions of professional men, whether they were groups of sellers or buyers. He allowed the *Muhtasib* to interfere and determine the price of the equivalent whenever monopolistic elements appeared in the market.
4. Within this freedom, he recognized the effects of increasing demand or declining supply on prices. He approved the resulting increase in prices since "forcing people to sell at a given price is compulsion without any right," and although the seller should not be forced to give up profit, at the same time he should not be allowed to hurt others.[22]
5. Any deviation from the honest practice of economic freedom such as false oaths, incorrect weights, and ill will is criticized by the Islamic writers,[23] along with production and trade in commodities which are condemned as bad for the health or for moral reasons according to the Qur'anic norm, such as alcoholic beverages, drugs, prostitution, gambling.[24]

Cooperation

The Islamic economy is a free one, but its freedom is expressed more in cooperation than in competition. Indeed, cooperation is a general theme of the social organization of Islam. Individualism and social awareness are so inextricably interwoven that working for the welfare of others is the most promising way of extending

[21]Siddiqi. *The Economic Enterprise in Islam*, p. 85.
[22]Kahf., *op. cit.*, pp. 18-19.
[23]Mannan, *op. cit.*, pp. 191-192.
[24]Abul-A'la -Maududi. *Al-Riba*. Lahore: Dār ul-Uruba, 1958, p. 67.

one's usefulness and pleasing Allah.[25] Thus Islam teaches its followers to consider doing good to the society as serving Allah and urges them to do their utmost to benefit others. This teaching is to be found throughout the Qur'an and is expressed in the life of Prophet Muhammad, peace be on him. The principle of brotherhood is very much emphasized in the Qur'an and the *Sunnah*, to the extent that many of the Companions of the Prophet shared their personal properties with their brothers in Islam. The consciousness and care for relatives in the extended family is also another example of the social orientation of Islam, since doing good to such relatives is not only urged but also made obligatory and regulated by law. Neighborless is very much stressed in both the Qur'an and the *Sunnah;* in this also we have another expression of the social awareness which Islam inculcates.[26] And lastly, consciousness, concern and preparedness to serve and sacrifice if the need arises for the benefit of the whole society is very strongly emphasized.

The Islamic teachings in general, and the verses of the Quran in particular repeatedly emphasize the value of cooperation and collective work. Cooperation for the purpose of doing good is a command of Allah conveyed in the *Qur'an*.[27] Whether in respect to spiritual matters, economic affairs or social activity, the Prophet, peace be on him, emphasized cooperation among Muslims as the foundation of the Islamic society and the secret of its performance. He says, "You find the Believers in respect to their mutual love, mercy and compassion as one single body, that if a part of it is in pain, all the body falls ill with restlessness and fever."[28] Sometimes cooperation may require the redistribution of income and property; the Prophet urges such redistribution by praising *al-Ash'ariyin*,[29] saying, "When *al-Ash'ariyin* have any shortage of food while traveling to battle, or when they are in a town and their food decreases, they collect all they have in one place and divide it equally among themselves. They are my own (group) and I am theirs."[30]

[25]The Prophet, peace be on him, is reported to have said: "All mankind are dependent on God. The one who is the most benevolent to His dependents is most beloved by Him." See Mustafa al-Siba'i., *op. cit.*, p. 184.

[26]The Prophet, peace be on him, said: "Jibril told me about the rights of one's neighbor, to the extent that I thought that the neighbor may be included among one's heirs." Reported by Muslim.

[27]5:3

[28] Reported by Muslim and al-Bukhari in *al-Adab al-Mufrad*.

[29]An Arab clan.

[30]Reported by al-Bukhari and Muslim.

In order to strengthen the social orientation of Muslims, Islam introduced the concept of collective obligations which carry individual responsibility and accountability. In Islamic jurisprudence this is called *Fard al-Kifayah*. The concept emphasizes the needs of the society and encourages individual effort in meeting them, since it holds every individual responsible as long as these needs are not met. *Fard al-Kifayah* means that in relation to areas of endeavor or knowledge which are essential for the Muslim community's well-being, it is sufficient if they are undertaken by some members of the community; but until the task is actually being performed by specific persons, every person in the community is individually responsible and accountable before Allah for it.[31] Consequently, M.N. Siddiqi denies the unconscious coordination of economic activities by an "automatic consistency of individual decisions" and a "hidden hand to make blind action fit together to produce ideal results." he asserts:

> "Islam entertains no such philosophy. It calls for conscious efforts for the achievement of the desired ends, disturbing wherever necessary, the state of affairs which has automatically come into being. It calls for redistribution of wealth and establishment of permanent institutions for such redistribution. It never regarded every form of trade, business contracts, land tenure and productive enterprise as valid simply because it automatically appeared into being and was 'natural'. Rather it subjects each and every activity to microscopic examination, casting aside all those forms which are hostile to social interest and carry undesirable effects."[32]

Government Involvement in the Market

The involvement of the government in the market is not occasional or temporary. The Islamic economic system views government as co-existing in the market together with other economic units on a permanent and stable basis. It is seen as a planner, supervisor and producer as well as a consumer.

a. The political body in the Islamic society works within a well-defined set of 'norms' for economic activities. A particular pattern of consumption and distribution is set forth in the Islamic teachings and the system derived from

[31]Abdul-Wahhab Khallaf. *Ibn 'Usul al-Fiqh*, Kuwait: -Dar al-Kuwaitiyah, Eighth Edition, pp. 108-109.

[32]Siddiqi, *Some Aspects of the Islamic Economy*, pp. 19-24.

them. Since Islam does not believe in the "invisible hand," production and distribution should be organized to achieve the said pattern. The Islamic government should take this role of planner and organizer.[33] To fulfill the production plan the state can go as far as to redistribute employment among industries on the basis of certain quotas if the free choice of peoples' occupations fails in meeting the requirements of the plan.[34]

The minimum standard of living is something to be determined by the degree of development and other circumstances. The distribution plans attack concentrations of wealth through three independent schemes: first, through the Islamic law of inheritance which distributes the property among a number of heirs, second, through the principle of *Zakah* which takes from the rich and gives to the poor, and third, through the provision of "surplus consumables," which implies that whenever there is a needy person in the Islamic community no one has any right to a surplus of essential consumer goods before that persons' needs are met.[35] However, neither of these schemes aim at any proposition of absolute equalitarianism.[36]

b. Public enterprise plays a significant role in the Islamic economic system, going hand in hand with public ownership. Public ownership in Islamic thought not only includes what is conventionally known as public utility, such as roads and rivers, but, in addition, what is known in the Islamic literature as "the publicly-shared sources of utility". This position originates in the stand of the Prophet, peace be on him, when he refused to admit any private ownership of such sources. He is reported as saying, "All individuals share water, fire, herbage and salt."[37] Dr. al-Siba'i comments on this, saying that these should be understood as examples only; all the types of goods mentioned are necessities of desert life and there is no reason to limit application of this principle to these goods in urban life.[38] Prof. al-Mubarak includes under this head-

[33]Siddiqi., *The Economic Enterprise in Islam*, pp. 84-5.
[34]Al-Mubarak, *op. cit.*, pp. 45-46.
[35]Al-Siba'i., *op. cit.*, pp. 209-211.
[36]Maududi, *Al-Riba*, pp. 62-63.
[37]Al-Siba'i, *op. cit.*, p. 132.
[38]*Ibid.*, p. 133.

ing all minerals which exist below the surface of ground, whether they are found in privately-owned or public land. He adds that the government is not permitted to grant any personal franchise to any individual upon these minerals, nor upon land which is not privately owned.[39] Abu-Zahrah discusses the concept of things being 'the bounty of Allah' as the basis for the public ownership of minerals, so that the value of the product cannot be attributed to the labor put into it. He also emphasizes that individuals are not allowed to own these resources and that it is not legitimate for the government to permit it.[40] Another view of public ownership in Islam distinguishes between publicly-shared property and state-owned property. With regard to the former, every individual has the right to satisfy his personal needs by utilizing publicly-shared goods such as water in a river. The latter refers to governmental enterprises which exist for the exploitation of such resources as hydro-electricity, mining and salt.[41] But there seems to be no practical economic significance in such a distinction, since individuals are now allowed to use the publicly shared resources beyond the scope of their immediate personal consumption.

c. The role of the government in relation to insurance is of special importance in the market mechanism. Social insurance in Islam is based on two things: general mutual responsibility and the claim of the public upon the government revenues. This general mutual responsibility is one of the duties imposed on Muslims, and they should fulfill it within the limits of their capacities. The government's guarantee of a minimum standard of living stems from the fact that it acts as an agent of the public and it is authorized to collect enough funds through *al-Zakah* to finance this guarantee. The second basis for social insurance, namely the right of the public over government's revenues, is a direct one. It imposes a direct duty on the state toward individuals which implies not only the guarantee of a minimum subsistence, but an adequate level of living as compared with the general level prevail-

[39]Al-Mubarak, *op. cit.*, pp. 103-104.
[40]Muhammad Abu-Zahrah. *At-Takaful al-Ijtimā'i fil Islām*. Cairo: Dār alQawmiyah, 1964, pp. 29-30.
[41]Al-Sadr, *op. cit.*, pp. 439-449.

ing in the society. This delicate distinction has certain important implications:

1. The state takes over the debts of all those who are unable to repay their debts. These people are known in the Islamic Jurisprudence as *al-Gharimeen.*[42]
2. It bears the debts of an individual who dies with debts exceeding his property.[43]
3. It guarantees an adequate standard of living, as determined by the level of the society, to one's successors after one's death.[44]
4. Workers are specifically assured of housing, the means to marry and transportation. Dr. as-Siba'i quotes a saying of the Prophet, peace be on him, which establishes this guarantee.[45]

We are primarily interested, in this section, in studying the impact of social insurance on the market's functioning rather than formulating its theory and its place in the Islamic thought. In this connection, one should investigate, for example, the stabilizing effect of the guarantee of payment of debt on transactions and individual initiatives, the effects of the assurance of minimum housing, the means for marriage and transportation programs for workers guaranteed by the government on wages and the cost of production, and the interaction between governmental insurance programs and the volume of the public productive sector.

d. The last important point which characterizes the involvement of government in the market is its supervisory and control function. There are two types of controls on the market mechanism. The first is intended to enhance the efficient fulfillment of the objectives of the state, as discussed previously. In this regard Dr. Siddiqi says that human life and the material world in which it is to be lived, are so constituted that the desired ends always call for some intervention by the state. This fact, supplemented by the equally important fact that the full conformity of all the economic units to the prescribed behavior is a

[42] 8:60.
[43] Al-Sadr, *op. cit.*, p. 619.
[44] *Ibid.*, and al-Siba'i, *op. cit.*, p. 158.
[45] Al-Siba'i, *ibid.*, p. 157.

highly unrealistic proposition, explains the existence of many permanent provisions for government intervention in the Islamic code. While the economic role of the state in bringing about the desired conditions is liable to contraction or expansion according to the exigencies of the situation, it is never allowed to contract beyond the limits established in the Islamic law. The state is always an active participant in economic life, and the functioning of the market mechanism is never fully relied upon.

The second type of control is performed by an independent agency, *al-Hisba*, whose function is to look after the adherence of 'the rules of the game' to be discussed in the following sub-section.

The Islamic Economy's 'Rules of the Game'

By this term we mean the set of social, political, religious, moral and legal commandments and rules to which a given society is committed. Social institutions are structured in such a way as to orient individuals toward the correct performance of the implications of these rules and to control and supervise this performance. The operation of these rules constitutes the surroundings within which individuals practice their economic activity. The rules themselves are derived from the conceptual framework of the community in relation to the Supreme Power, life, man, the world, creation and man's ultimate destiny. Here we will simply survey the main rules of the Islamic economic 'game' without going into the implications derived from them, which are outside the scope of this paper.

a. The whole universe, including man, belongs to the Allah, Who has full and complete sovereignity on His creatures. Man is undoubtedly the highest order of being among that Allah has created, and everything in the earth and the heavens is placed at man's disposal. He is authorized to use all this as a vicegerent or steward on behalf of Allah. Man is given the power to carry out this vicegerency and to extract as many benefits and utilities from these things as he can.[46]

b. Allah has ordained such limits on man's behavior as will

[46]Abdul-Qader 'Audah. *Al-Māl wal-Hukm fil-Islam*, Beirut: Manshurat al-'Asr Al-Hadith, Fourth Edition, 1971, pp. 11-14.

benefit the individual without sacrificing the rights of others. He has imposed certain obligations on human beings; their performance, prescribed by the Law of Allah is to be supervised by the community as a whole, on the basis of the Islamic rule that the rights which man owes to Allah in relation to social affairs are obligations on man towards the Muslim community.[47]

c. All human beings are dependent on Allah. The more benevolent a person is to Allah's dependents the more beloved he is by Him. Everyone is personally responsible for the improvement of the community and the removal of its difficulties; this individual is ultimately responsible for any failure of the community's co-operative and collective effort.

d. The status of vicegerent or steward of Allah is general for all mankind; there is no specific privilege for any particular individual or nation as far as the vicegerency is concerned. This does not mean, however, that human beings necessarily are or should be equal in the benefits they extract from the universe. They are equal only in opportunity, and each one derives as much benefit as is within his capacity. Individuals are created with different capabilities so that they are instinctively disposed to live together, work together, and utilize each others' skills. But this does not imply or grant any superiority to the employer over the employee in relation to his worth as a human being or his status before the law. It is only incidental that at a particular time this is the employer and that is the employee. At another time the situation might be reversed and the ex-employer might become an employee, etc; the same thing can also be said about slave and master.[48]

e. Individuals are equal in their human dignity. No differentiation can be made or claimed on the basis of color, race, nationality, religion, sex or age. Each individual's economic rights and duties corresponds with his capabilities and the normative roles of each in the social structure. It is on this basis that some differences exist between adults on the one hand and the aged and growing on the other, or between male and female. Whenever such

[47] *Ibid.*, p. 48.

[48] *Ibid.*, pp. 15-16; al-Mubarak, *op. cit.*, p. 26; and al-Siba'i, *op. cit.*, p. 155.

differences exist, they affect both the rights and the obligations in such a way as to keep some sort of balance between them.

Islam does not consider the existence of socio-economic classes as contradictory to the general principle of equality as well as to the principle of brotherhood.[49] Economic power is distinguished from political and social power partially because of the fact that the broad objectives as well as many details, are laid down in the-Qur'an and the-Sunnah, and by the constancy of the methods used by Muslims in legislating the nonspecified details.

f. In Islam work is considered a virtue and idleness a vice. In the modern Islamic literature one will find many details concerning this. The Qur'an addresses the Prophet, telling him: ". . . and say (to the Muslims): Work." The Prophet is reported to have prohibited begging unless it is owing to starvation. The best worship is work,[50] and work is at the same time both a right and a duty. It is the obligation of the society and its representative body to provide individuals with job opportunities. Manual labor is honored and the Prophet, peace be with him, is reported to have kissed the hand of a laborer. Monasticism and asceticism are prohibited; the Prophet is reported as saying that those who provide food and other necessities to the one who spends all his time engaged in worship without attempting to earn a livelihood are better than him. Consequently, leading the prayer and giving the sermon in Islam is an unpaid voluntary job. The Prophet used to ask Allah to preserve him from disability and laziness among other things.

g. Life is a dynamic process toward improvement. The Islamic teachings look at human life in this world as a race with time. A man's lifetime is very limited and there are a great many improvements to be effected within this very limited span. Betterment and perfection are in themselves goals in this process.[51] The Prophet, peace be on him, is reported to have ordered a grave digger to correct a superficial hole on a grave although it was only at the sur-

[49] Mannan, *op. cit.*, pp. 63-68.

[50] Al-Banna, *op. cit.*, pp. 393.

[51] This has no link with the philosophical school of "Perfectionism" which made its appearance in Europe early in the Modern era.

face. He established the rule that "Allah like the one who, when he does anything, does it in an excellent manner."[52]

h. "No harm, no injury,"—this phrase was reportedly used by the Prophet, peace be on him. It refers to "injuries consciously planned and inflicted by the individual, as well as to the mere presence of injury. The very fact of injury being inflicted upon any one is the focus of attention whether the injurer intended to inflict the injury or not. Injury is to be eliminated regardless of the intention behind it. But we must be realistic enough to note that complete elimination of 'injury' from human life is impossible. Injury in itself is always undesirable. Yet when it is a necessary condition to the achievement of something good and greater, it may be tolerated."[53]

i. A minimum level of goodness is clearly defined. The performance of this level is controlled by social institutions, which ultimately impose it by the power of the law.[54] It is not sufficient, in Islam's view, to count only on individual initiatives to perform, say, acts of charity. As a matter of fact, a large part of what is left to voluntary charity in a non-Islamic society is supported by law in an Islamic society.[55] The Muslim is urged by the ethical system of Islam to go beyond the minimum level in doing good. Obeying the Islamic teachings in all aspects is considered in Islam as a means of obtaining the pleasure of Allah.

There are the principles on the basis of which the market functions in an Islamic society. All prices, whether of the factors of production or of products, stem from this mechanism, and because of this are regarded as being just or fair prices. This may not agree with Siddiqi's concept of 'just price' as based on the cost of production; hence, in this study, it is preferable to use the term 'the price of the equivalent' instead of the 'just price.' This makes our terminology more compatible with the traditions of Islamic jurisprudence and expresses the conceptual content of the term more satisfactorily. A detailed discussion of 'the theory of the price of equivalent' may be found in "The Economic Views of Ibn Taymiyah."[56]

[52]Al-Siba'i, *op. cit.*, p. 155.

[53]Siddiqi, *The Economic Enterprise*, pp. 43-4.

[54]Kahf, "The Economic Views", pp. 27-28.

[55]Al-Siba'i, *op. cit.*, pp. 179-99.

[56]Kahf, "The Economic Views", pp. 4-11. Also Nuri 'Abdul-Salam Beriun. *Mafhum al-Arbah fil-Iqtisad al-Ta'awuni.* Tripoli, Libya: Dar Maktabat al-Fikr, 1969, p. 71.

The second comment on the previous analysis is that the market mechanism in an Islamic society does not imply an atomistic structure. It is true that Islam precludes a coalition between suppliers and demanders, but it does not exclude the possibility of accumulation of wealth or concentration of production as long as no dishonest methods have been used in the process and they do not violate the principles of freedom and cooperation. However, in practice the existence of accumulation and/or concentration of wealth may call for government intervention. This intervention may either take the form of a government takeover of the monopolized production or governmental control and pricing.

The third and last point relates to the value theory. There is no split, in the Islamic economy, between the normative usefulness of a commodity and its economic value. In other words, what is forbidden for use has no economic value.[57] Accordingly since wine has no value in an Islamic society, any existing supply must be gotten rid of, and any effort put into its production and distribution will be considered an absolute waste in economic terms.

[57] Abdul-Rasul, *op. cit.*, pp. 9-11. See also Chapter II of this book.

Chapter V

THE MACRO-MONETARY THEORY

In this chapter we will study the macro aspects of the economic system of Islam and their monetary implications. In the first six sections, the components of the macro-monetary theory are briefly studied; in the seventh section, the dynamics of the model are studied, and, in the last section we will deal with proposals for interest-free banking.

Al-Zakah[1]

Al-Zakah is a special yearly tax levied on the total net worth of an individual's property, to be collected by the state and spent for specific purposes, primarily the several types of social insurance. Ordinarily government expenditures cannot be met by *Zakah* funds. *Zakah* is due on all types of wealth and includes the savings added during the year as long as the beginning-of-the-year stock is above the exempted minimum. It is assessed on net worth at a fixed percentage rate in case it exceeds a pre-determined minimum level, payable at the end of the year.

These characteristics give *Al-Zakah* a pivotal role in the Islamic macro system. It is assessed on the net worth, whether this net worth is used in productive activities, kept idle, or even spent for luxuries.[2] *Zakah* controls (a) the allocation of productive wealth among alternative uses, (b) the non-productive means of production, (c) the allocation of income between expenditure and saving, (d) the allocation of savings between productive uses and durable luxury goods, and (e) the long-run redistribution of wealth.

Before proceeding to analyze each of these effects, it is important to note that (i) while bullion, money (paper, coins and de-

[1] Throughout this work, the Islamic terms have been used whenever it is felt that no single English idiom can express their content.

[2] A small number of writers exempt some types of luxuries such as women's jewelry.

posits), and debts on others are included in the net worth, agricultural land is not; (ii) public ownership is not subject to *Zakah*, (iii) the fixed percentage has been set by the Prophet, peace be on him, at 2.5 percent (or some equivalent in case of cattle) for all net worth, except the flow of agricultural products where the percentage is 5 or 10 percent depending on whether the land is irrigated by rain or by hand (we must keep in mind that there is no *Zakah* on land), (iv) the percentage of *Zakah* is independent of income, which may range from minus to plus as long as the net worth at the end of the year is above the minimum exempted level, (v) *Zakah* is to be given to a person who deserves it, say to a poor individual, so that he becomes the owner of it, and (vi) the payment of *Zakah* is obligatory on net worth and not on total wealth.

a. The marginal profitability for the private sector should not normally go below the percentage required to keep net worth non-decreasing. This percentage is 2.564. This is clarified in Figure 1, with MPK being marginal profitability of capital. The equilibrium level of capital invested by the private sector is at K_e' with MPK equalling Z (*Zakah*). Under abnormal conditions owners of wealth are expected to keep investing until the point at which MPK is zero because at any level above zero they are better off than they would be noninvesting. In fact, the choice at MPK below Z is a choice between investment and consumption rather than investment and idling the wealth, as will be shown later. A little digression is required here to compare the MPK for the private sector of the entire economy with its equivalent on the micro-level of the firm. Since *Zakah* is not a cost of production and its payment is due whether one produces or not, the marginal analysis becomes irrelevant on the level of the firm. For the firm, it is the average profitability of capital, APK, which is relevant, and not MPK. This implies that equilibrium of the firm is where APK = Z, i.e., at k_e in Figure 2. This point lies beyond K_e'conceived of in the marginal analysis.

This shows that the conventional method of aggregation which is based on incremental changes is misleading in the case of the MPK schedule. MPK should be understood in this analysis not in terms of incremental changes but as a hierarchy of the averages of the profitability of capital on the micro level. In other words, it tells us the minimum average profitability of capital at each level of capital stock.

The preceding discussion is carried on in both stock and flow types of analysis. From the characteristics of *Zakah*, we conceive

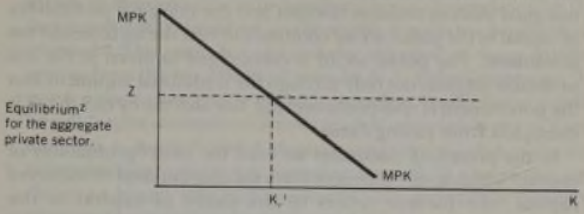
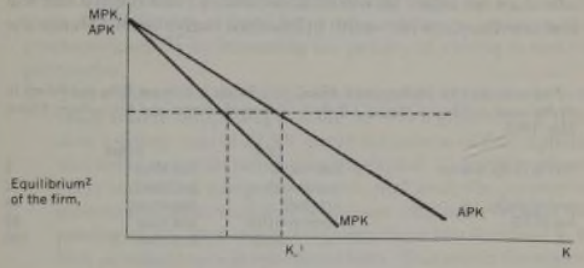


Figure 1



that in each period of time the existing stock of capital is reviewed in terms of its profitability at that time. It is carried over for the allocation of new net investment as well. This implies that gross investment (net plus replacement investments) is a more relevant variable to our analysis. The same result can be obtained if we approach the point from the preceding average-marginal analysis.

The previous line of thought does not apply to the public sector as such. The public sector is not subject to *al-Zakah*, a fact which allows it to consider zero as the minimum level of profitability. For

the public sector, conceived of as one consistent central plan, the marginal analysis remains relevant and the marginal profitability of capital in the public sector continues to rule the incremental net investment. The public sector is encouraged to invest in the less profitable projects not only through the traditional argument that the government is non-profit-seeking, but also the by fact that it is exempted from paying *Zakah*.

In the preceding discussion we used the term "profitability of capital," which is very different from the conventional efficiency of capital; the former refers to the share of capital in the 'monetarized production' which will be schematized later in this chapter. This share plus the share of the working partner constitute what is in conventional analysis understood as the rate of return on capital. We will call the latter the profitability of the firm.

b. The characteristics of *al-Zakah* mentioned above, taken together with the fact that the exempted minimum level is very small (the equivalent of 12 British gold sovereigns)[3] means that the one who does not utilize his wealth in production and keeps it idle will lose one-fourth of his wealth in less than twelve years.[4] Hence the

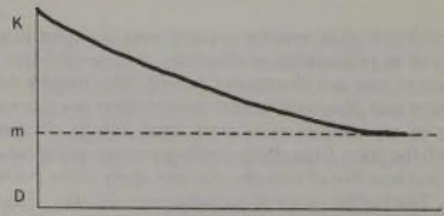
[3]As estimated by Muhammad Abu-Zahra in his article on *Riba* published in *Al-Mu'tamar al-Thani li-Majma' l-Bukuth l-Islamiyah, Papers and Proceedings*, Cairo, May 1965.

[4]$m = K(1-Z)$, where:

$n = \log(m/K)$, i.e.,
$\log(9.75)$

Loss	Years	
one-tenth	less than	5
one-fourth	less than	12
one-half	less than	28
three-fourths	less than	55
90%	less than	100

So the time path of non-productive wealth is asymptotically convergent to the minimum level as shown below:



Graph—Pg. 50

Prophet, peace be on him, urged his community to invest the wealth of the orphan and he justified his recommendation by the fact that *al-Zakah* would eat up the wealth if it was not productively invested.[5] This point has claimed the attention of many Muslim writers from the late 1940's till now. M. S. A. Irshad comments "*Le monde n'a pas connu d'autre systeme economidque lequel a dissout le problème de l'argent accumule qui demeur sterile et refuse le bien etre qu'il peut fournire a la Société.*[6] Abdul Mannan considers *al-Zakah* as the uncompromising penalty for hoarding because "it checks the tendency to hoard idle cash resources and provides a powerful stimulus for investing these idle stocks."[7]

He may add that *al-Zakah* penalizes not only "*l'argent sterile*" and "idle cash resources" but the idled means of production as well. In this manner *Zakah* deals with "waiting resources" and tries to put them back into economic activity as increased capacity or as increased demand for consumption.

The very low minimum exempted level is of special significance in the drive toward productive investment waged by *al-Zakah*. In short, the obligation of *Zakah* helps to force every bit of wealth into productive activity by increasing the penalty of waiting to make it productive.

c. The effect of *al-Zakah* on the allocation of income can be very easily traced. Supposing that the APK in a given firm is 10%, then a saving ratio of 27.5% out of the income of that capital is needed to maintain nondecreasing capital. This makes almost every individual merge, at any practical level, the decision of income allocation with that of savings utilization, because the passing of any time interval between these two decisions is, in fact, penalized on a proportional basis. This makes the opportunity to invest a direct element in income allocation choice. An example will help to clarify the merging effect of *Zakah* on the saving-investment decision: in order to abstrain from consumption today, I should expect an increase in my gross wealth (before *Zakah*) equalling at least Z plus my preference of today over tomorrow, barring expectation of price change. This does not mean an increase in the rate of interest simply because it cannot, by law, exceed zero as we shall see later. The third

[5]Majma' al-Buhuth al-Islamiyah, *ibid.*, p. 159.
[6]Mo'tamar al- 'Alam al-Islami, *op. cit.*, p. 68.
[7]M.A. Mannan, *op. cit.*, pp. 220-221.

element on the saving side is seen as resulting from the fact that the minimum level is very low. This makes the decision as to whether to save or to invest the concern of every wage earner. As Shaikh Mahmud Ahmad puts it: "Islam suggests two alternative channels to which surplus wealth should be directed, either spending that wealth on comforts of live or investing it in productive activity."[8]

The preceding emphasizes the economic effects of *al-Zakah* on the *Zakah* payer. This can be summed up as an upward shift in the savings function of the individual, element one; a further upward shift when aggregating, element three; and a tighter relation to investment, element two. We will now take a look at the effects of *Zakah* on its recipient. We will use this occasion to recall that *Zakah* is a function of local government, as this term is understood in the United States, as long as the local government is able to spend it in the eight categories of expenditures specified in the Holy Qur'an, (9:60), whose order of heirarchy is somewhat flexible and subject to the judgment of the society and its representative central administration. This has an effect on environmental improvement programs, social activities and the *Zakah* payer's psychology.

Four out of the eight categories, on which *al-Zakah* can be spent relate to socio-economic insurance. These are: support for the poor, the needy, travellers and those who are in debt.[9] A fifth category is sufficiently general, to include every activity which can be classified as good or beneficial to the society by the Islamic criteria. The sixth category is intended to improve the morals and behavior of individuals who are weak or have aggressive tendencies, and the seventh is a translation into action of the understanding and practice of personal freedom, that is, to spend for the ransoming of captives or the manumission of slaves. The eighth category is the financing of the activities of the *Zakah* administration and its employees.

The spending of *al-Zakah* need not be limited to short-term provision. As a matter of fact, most of the Islamic writers give more emphasis to enriching the poor and needy by providing them with means of production and circulating capital, skills, training and employment, in order to raise their earned income, together with the necessary short-term comsumer goods, transport, residential facilities, etc. There is no special injunction concerning the dis-

[8]Shaikh Mahmud Ahmad, *op. cit.*, p. 88.

[9]The last category is especially significant in relation to providing confidence for economic transactions. This will be discussed further later.

tribution of the *Zakah* funds in cash, claims on consumer goods such as food stamps, or direct distribution in terms of real goods and services. The only limit which one can see is that imposed by the minimum exempted level, the rule being that "one who pays *Zakah* is not eligible to receive it". The minimum exempted level is conceived in terms of stock remaining over a period of one year. It has nothing to do with the size of flow of income with transaction demand for means of payments (as comprehended from Baumol analysis),[10] which is exhausted by the end of the period of income. It is the stock of wealth remaining unchanged over the period of a full year in excess of what is commonly accepted by the society as non-luxurious durable consumer goods, plus the previously mentioned exempted minimum. In other words, all the non-luxurious durables[11] used by the household are excluded from the definition of net worth as far as the imposition of *al-Zakah* is concerned. The minimum exempted level of net worth as defined above is what is usually referred to as *al-Nisab*. Any one of the first four above-mentioned categories of persons who are eligible to receive *al-Zakah* who possesses *al-Nisab* during a full continuous year is not eligible to receive *Zakah*, no matter how low his income may be. In order to be qualified to receive *Zakah*, he should spend whatever he has above *al-Nisab*. Then any shortage of his income below the minimum standard of living is paid by the fund, although payments from the *Zakah* funds are not limited by the amount equivalent to *al-Nisab*.

The previous discussion leads to the conclusion that *al-Zakah* does not decrease the aggregate demand and may even increase it, depending on the shape of the consumption function we adopt and on the allocation of the *Zakah* funds. This conclusion is supported by the fact that these funds should be allocated during the year and no leftover is, as a matter of principle, allowed. This can be simply deduced from the unlimited capacity of the funds to absorb any amount of money, which constitutes one of the above-mentioned purposes of *al-Zakah*.

The allocation of the aggregate demand created by *al-Zakah*, between investment and consumption, is left to the executive authority to manage according to the actual economic conditions of the time and the goals of the economic policy.[12]

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[10]See D.E.W. Laidler, *The Demand for Money: Theories and Evidence*, Scranton, Pa.: International Textbook Company, 1969.

[11]This is socially and culturally determined.

[12]See pages 84-85.

It is not intended here to create an impression that *al-Zakah* is the only crucial factor in decisions concerning income allocation, nor it is intended to exaggerate the role of *al-Zakah* in this respect. Whether or not it is a crucial factor in such decisions at the margin is a question which can be answered only by empirical work in an Islamic society. Since such a society does not exist at the present time, all our theoretical analysis can do is to assert that the most likely answer would be, "Yes."

d. As we have seen *Zakah* is not imposed, on non-luxury durable goods, while in the case of savings invested in productive uses their income offsets the payment of *Zakah*. However, when savings are converted into luxury durables, they are considered idle and hence are penalized accordingly. What constitutes luxury is socially and culturally determined; Islam does not approve some uses of wealth which may be approved by other communitites. Hoarding in itself is a vice. For example, the use of precious metals for household implements or utensils is looked upon as sin by Islam.

> "And there are those who bury gold and silver and do not spend it in the way of Allah. Announce to them a most grievous penalty on the Day when heat will be produced out of that (wealth) in the fire of Hell, and with it will be branded their foreheads, their flanks and their backs.—'This is the (treasure) which you buried for yourselves. Taste, then of the (treasures) you buried' "[13]

e. *Al-Zakah* affects the long-turn distribution of wealth and income in the direction of equalitarian conditions. Business on any micro level is subject to losses and gains. Since *Zakah* is levied on the net worth in excess of the exempted minimum without any consideration of the business losses, it can be mathematically proved that, at any given moment, those who are presently affluent will not be able to maintain the same level of wealth over a long period of time as long as the probability of losing is not negligible. This depends on the rate of expected profit (+ or −), the probability of the occurrence of losses, and the constant rate of *Zakah*. The positive effect on the redistribution of wealth is much more significant. This will be evident if we recall two characteristics of *Zakah*. First, the funds are to be distributed among the deserving, i.e., not kept in the *Zakah* Fund, no matter whether it is distributed in terms of

[13] 9:34-35.

cash, consumer's goods or producer's goods.[14] Second, the distribution is not limited by *al-Nisab* i.e., the recipient can be given that quantity which will meet his needs according to the current standard of the community, with the intention of improving his capacity for earning so that he can move out of the *Zakah* recipient's group. This shows that both *Zakah* and the Islamic system of inheritance tend toward egalitarian distribution of wealth, and that, as a result of *Zakah*, wealth always keeps circulating. These two aspects in fact characterize the dynamics of the Islamic economy and are deeply rooted in the Islamic conception of social life.

The short-term distribution of income is more apparent. It is simply accomplished whenever the distribution is achieved by means of consumption goods or the equivalent.

The discussion of *al-Zakah* and its role in the Islamic scheme of economy can be summed up by a comparison between *Zakah* and other taxes. The principal difference is that *a-Zakah* as such is a part of the Islamic system, while taxation is merely included as a general economic principle. All other taxes are in the hands of policy makers, whose authority is very limited as far as *Zakah* is concerned. The other difference lies in the inducement underlying *Zakah* and other taxes. *Al-Zakah* is supported by the moral and religious incentive which is so strong that it constitutes the third pillar of Islam, so that it is just as clear and binding an obligation on Muslims as is the obligation of prayer. It is, at the same time, also supported by the power of the law. Other taxes are usually supported by the latter only, without the existence of any religious motivation or injunction.

[14]Some writers have argued that the *Zakah* Fund is allowed to initiate productive project, keeping their ownership in its possession and providing employment and then income to the poor and the needy. What these writers have missed, I think, is that such a process will undoubtedly result in the *Zakah* Funds owning all the means of production in the long run, which is by no means the intention of Islamic system. It will also result in the elimination of that part of the *Zakah* money itself which is levied on the wealth of the *Zakah* Fund. This of course does not imply that the *Zakah* Fund should be kept from helping the poor to get the benefit of large-scale production on the basis of the worker-shareholder principle.

Al-Rība

Al-Rība, as understood from the Qur'an, is any payment imposed in excess of the principal of the loan.[15] It also includes, as a corollary, the excess in quantity in the barter exchange of the same commodity, e.g., 12 for 10 pounds of wheat, without any consideration of whether excess can be justified by quality differential or not.[16] *Riba* is unequivocally prohibited in the Qur'an and *Sunnah*. There is no dispute whatever about this in the Islamic literature, ancient or modern. This implies that two types of transactions are excluded from the Islamic system: first, interest on loans, and second, barter exchange of the same commodity of different qualities. In this section we will consider the first type only and the second will be tackled in Section 4.

Before any economic analysis of the interest-free economy of Islam, can be undertaken, the tremendous difference of thought among the radical and moderate thinkers is worth brief mention. The dispute is focused upon two points: whether there is any difference between consumption and production loans, and whether the rate of interest is to be considered or not. These two points are in reality merely the reflections of a basic question which is, Shall Muslims accept the *status quo* (i.e., banking with interest) which exists in Muslim countries today with some few changes, or is this *status quo* as a whole, un-Islamic, requiring replacement by an Islamic system. In these discussions the outside observer can trace the political affiliation of the writers, especially on issues related to nationalization of commercial banks or post office saving deposits.

Some writers have argued that the Islamic prohibition of interest is restricted to the interest on consumption loans and does not apply to production loans on the basis of the fact that the former constitutes an exploitation of the needy and contradicts the spirit of Islam, while the second is in fact a collaboration between lender and borrower to increase the utility of wealth and they should both share that increase; moreover, in these loans, the lender, (i.e., the saver), is the economically weaker party and the borrower is the economically stronger, as opposed to the case of consumption loan to the needy.[17] In rejecting this view al-'Arabi argues that it is more

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[15] Muhammad Abu-Zahrah. *Buhuthun fi-Rība*. Beirut: Dar al-Buhuth al-Islamiyah, 1970, pp. 28-30.

[16] Sayed Qutb. *Tafsīr 'Ayat al-Riba*. Beirut: Dar al-Buhuth al-Islamiyah, no date, pp. 22-23. Some writers have argued for the inclusion of this last excess into the definition of *Riba*, see pages 60-61 of the present work.

[17] Abdul-Rasul; op. cit., pp. 81-88.

likely that what has been forbidden in the Qur'an is really interest on production loans, since this was the pillar of trade in Makkah at the time of the Prophet, peace be on him.[18] However, the prohibition of interest is part of an economic system based on the fundamental teachings of Islam rather than being simply a moral injunction which happens not to fit in with the situation existing in Muslim countries today.[19] Other writers on the subject have rejected the moderate position based on the fact that Islam is a system for organizing human life in all its aspects. Interest on production loans disturbs the internal harmony of the Islamic system, which can only function in a consistent manner without interest.

The argument concerning the distinction between interest and usury in the late Middle Ages in Europe had its impact on some writers, who applied it to making a distinction between *Ribā* and interest on the ground that interest is not regarded as *Ribā* as long as its rate is not usurious. This claim does not deserve serious attention because it is clearly stated in the Qur'an that at the expiry of the time limit of the loan, the lender is only permitted to receive his principal without any addition.[20] Actually, this distinction does not have any theoretical base but is more or less a pragmatic attempt to 'Islamize' the un-Islamic situation existing today in Muslim countries.

Interest, Rent and Capital

Earlier in this study, an attempt was made to clarify the Islamic concept of capital by showing the difference between the capital as the material goods used in producing other goods and services, which is a real phenomenon, and loan as a monetary phenomenon. The 'rent of the machine'[21] denotes the price of the first, while interest constitutes a duty imposed on the second. This same distinction implies a difference between the capital market, which is a long-term market, and the monetary market, which may be long or short-term. A confusion arises here because of the conventional use of the term 'capital' in a broad sense, for we always hear of

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[18]Muhammad 'Abdullah al-Arabi: *Al-Nizam al-Iqtisadi*, Cairo: Ma'had ad-Dirasat al-Islamiyah, 1967, pp. 4-8.

[19]Muhammad Abu-Zahrah. *Tahrim al-Riba Tanzim Iqtisadi*. Kuwait: Maktabat al-Manar, no date, pp. 58-59.

[20]2:279.

[21]'Rent' is not intended here to convey the purely economic rent extracted by the more efficient units because the reward on the last machine, assumed to be the less efficient, which is equal to its marginal productivity under the set of conditions of perfect competition, determines the rental price per machine. What is meant by 'rent' in this study is the rental price itself rather than the simply economic rent.

short-term and long-term capital movements as being monetary movements. It is true that money buys goods, whether producer's or consumer's (conversely goods buy money), but it is also true that it buys labor and land as well. If we allow ourselves to identify rent with interest because money buys machines, we should, by the very same analogy, identify interest with wage rate and rent of the land. Using different units of measurement, namely the man hour and the acre for the latter, is no way out because we also can use the machine as a unit of capital. Moreover, it is also true that money is productive in the sense that the introduction of money in a barter economy reduces the ratio of inventories of output and factors of production to the level of activity of the producer, which increases the efficiency of a given collection of factors of production, while its basic function is to facilitate the exchange of the factors of production. Thus money affects the production function but does not enter into it as a factor of production, making it more comparable in this respect to technology that to capital.

In the Islamic literature, one can hardly find any distinction between hoarding and saving. Both are considered as the same, and the literature does not make any distinction between whether the income saved is measured in money units and is concealed under the ground or in the bank's vault as long as it is not put into the production process itself. The mere act of saving and depositing in a bank is an economically-negative action; therefore it should be penalized rather than rewarded, and this is actually the case in Islam. The real productive act, from economic point of view, is the introduction of these savings into the production process in terms of capital, land or labor, and this act should have its reward, and so it is in Islam. This latter act is known by two mutually substitutable terms in the Islamic literature: *al-Qirad* and *al-Mudarabah*.[22] The reward of *al-Qirad* will be termed 'profishare' in this study.

It is essential to be clear about the distinction between interest and profishare. The act of saving which is without a reward if we adopt profishare and which is rewarded if interest is accepted, must be distinguished from the act of substituting for savings by factors of production whose reward is interest in the conventional economic literature and profishare in Islamic literature. In other words, interest does not distinguish between the two actions and profishare does. As a result of this, interest allows these two acts to

[22]Hereafter, I will use the first term because some writers use the second as a translation of the term "speculation". This usage can save us from a lot of confusion in the literature.

be separated and made into two different stages. Profishare links them together by the very fact of not allowing savings alone to have any reward. It penalizes such savings with the imposition of *al-Zakah* combined with non-interest.

Al-Qirad

Al-Qirad is a sort of partnership between the owners of monetary assets and businessmen. It is an Islamic mechanism for introducing monetary assets into production activity by transforming them into real factors of production as a result of a joint action between the owner of the assets, who is known as *al-Muqarid*, and the entrepreneur.[23] The reward of the first party, which we term profishare, is a predetermined percentage of the total profit of the project; the remainder of this total—call it profit—is the reward of the entrepreneur. The crucial difference between profishare and interest charged on business is that the latter is a fixed burden on the firm, while the former is a share of the benefit of the project which fluctuates with the fluctuations of the results of the activities of the firm. Hence, since he is a real partner, the *Muqarid* has a direct interest and real concern in the activity of the firm, although he does not participate in the decision making. The *Muqarid* is interested in the profitability of the firm because his ultimate profishare is a positive function of the profitability of the firm; therefore, he seeks for efficiency, while the total concern of the interest-earner lies in his own income, which does not depend in any way on the degree of efficiency with which it is used. Thus the goal of the *Muqarid* is consistent with the goal of the entrepreneur, while this is not necessarily the case for the interest-earner.

Another difference between interest and profishare is that profishare is a long-term phenomenon in which the preference for liquid assets is almost negligible, whereas interest is both a short- and long-term phenomenon. Economic thought has not provided any acceptable theory for explaining interest and its term structure. Although there is undoubtedly some interaction between

[23]This definition diverges from the traditional definition of the medieval Islamic jurists on two points: they called the entrepreneur *al-Muqarid*, and they did not restrict his share to money assets. I have preferred the term *al-Muqarid* for the first party in order to study his activity as a separate economic factor, since I have used the term 'entrepreneur' as understood in the traditions of Western economics. The use of the term will be withdrawn when Islamic writers come to some sort of agreement on their terminology. From a practical point of view, in monetary economy *al-Qirad* in the form of non-monetary assets is of little importance. At the same time, the analysis can be generalized to include this very rare case.

short-term and long-term rates of interest, the short-term fluctuations are reflected on long-term investment phenomena by means of this duality. Herein lies the whole Keynesian argument of the effect of interest rate on investment. For profishare, the short-term changes do not interfere with the financing of investment unless it is through their effect on the expected rate of return. One source of long-term fluctuation is thereby eliminated, namely, variation in short-term interest rate. This discussion clarifies the very secondary role given to liquidity preference and to short-term engagement in business activity.

Theoretically *al-Qirad* has a dual basis; namely, the principle of constancy of ownership and the principle of co-operation. The principle of constancy of ownership implies that the *Muqarid* has full claim on his monetary assets as well as on the increase resulting from the growth of these assets brought about by the extra labor applied to them by the enterpreneur. The principle of co-operation implies that the two parties, sharing the elements that create the project and the interest in it, also share the fruits of it in the full sense of the word 'share' which cannot be realized by a fixed return to one party. The theoretical difference between profishare and rent of machine is that in the former the *Muqarid* is committed to a project as a whole unit, while in the latter the machine owner is committed to the machine. The machine owner is an independent entrepreneur working on the same basis as the firm that provides raw materials. Thus, the real difference between the *Muqarid* and the machine owner lies in the degree of attachment to the project at hand.

Al-Qirad is thus the Islamic solution to the economic dilemma of how the entrepreneur and the owner of monetary assets are brought together on common grounds. It is the solution which co-ordinates the interests of the two parties and fits the objectives of the Islamic system.

Money and Monetary Authority

To introduce this topic, let us consider the second type of Rība which prohibits the exchange of a commodity for a different quantity of the same.[24] The Prophet, peace be on him, did not deny the possibility of differences in quality but he rejected this sort of barter exchange, as is evident from those sayings of his which allow such

[24]According to Islamic jurisprudence, such a transaction is forbidden even though there might be certain differences in the quality.

an exchange only if it is split into two transactions carried out with money by both parties.[25] It is a fact that differences in quality are very difficult to estimate without the use of a common medium of exchange, money.

Barter may inject an element of ill will into transactions, and the 'demoralizing' effect it creates probably led to its rejection by the Prophet, peace be on him. In stating that transactions such as these would be permisible if they had been priced in monetary units, the Prophet was in part laying down the system on a monetary rather than on a barter basis.[26]

The issuance of money has attracted the attention of most writers in the field of Islamic economics during the last twenty-five years. It is considered as an element of the political sovereignty of the state. That the state is the only authority which can issue money is not disputed in modern Islamic thought; this privilege cannot be transferred to any franchise under any circumstances. The issuance of currency and the creation of demand deposits is included in this authority.[27] The very fact that commercial banks can only create demand deposits depending on the general strength and stability of the economy and the general confidence in the system implies that this activity should be managed by the state and not by any private party, especially because banks really sell what they do not own.[28] Moreover, the prevailing principle in Islamic jurisprudence is that anything in which the interests of the masses are involved should not be left in a few hands. When it cannot be left open to the public because of its nature or because of its investment requirements, it should be reserved for the state only. This principle is laid down in a saying of the Prophet, peace be on him.[29] Therefore commercial banks are not permitted to create money and this activity is the monopoly of the state. This issuance of money, whether in terms of currency or deposits cannot be a function of the interest rate as it does not exist in the Islamic system. Both currency and credit become direct tools of economic policy, and neither of them are to be determined by the interests of a private party.

[25]Zaidan Abul-Makarim. *Mathhab Ibn Abbas fi al-Riba*. Cairo: Dar al-Ittihad al-Arabi lit-Tiba'ah, 1972, pp. 49-50.

[26]Abul-Makarim, *ibid*, could not see this statement of the Prophet, peace be on him, in this perspective and unjustifiably rejected it.

[27]Isa Abduh. *Bunuk Bila Fawa'id* Volume 1. Beirut: Dar al-Fath, 1970, pp. 35-6.

[28]Monzer Kahf. "Contemporary Challenges to Islamic Economists," paper presented at the first National Conference of the Association of Muslim Social Scientists, Chicago, June 2-5, 1972, p. 6.

[29]Al-Mubarak: *op. cit.* p. 104.

In the Islamic literature, money is discussed as a tool of transaction, medium for evaluating goods and services; it is not allowed to play the role of a good. Looking at money in this way, the Islamic literature criticizes Patinkin's argument concerning money on two main grounds: first, his assertion that "money buys goods but goods do not buy money," i.e., money is not a "full tool" in the economy; and second, he has considered money the (n + 1) good, which implies that money is a good like other goods. Hence his model includes cross transactions among goods on the same ground as between money and goods, and while in the real life affairs of a monetary economy there is two-way traffic between goods on one hand and money on the other, there are no cross transactions among goods; i.e., goods are exchanged for money and money for goods but not goods for goods.

The direct result of the use of money as a measure of pricing is the manner in which its quantity affects transactions. This has been of concern in Islamic literature both ancient and modern. The effects on price instability of money arise from three sources. The first of these is the creation of new money, mainly inside money, by the banking system. This has been eliminated by relating both kinds of money (inside and outside monies) to the government and eliminating the interest rate as a motive for the multiplication of inside money. In fact, the unstablizing effect of changes in demand deposits is one of the main arguments given to defend the proposition of 100% reserve. Second, the withholding of money by not relating it to the investment-saving process has been considered as a sin and and economically bad practice; it is not rewarded (no interest paid) but rather punished (*al-Zakah* is levied). The third reason is the slower (or zero) rate of growth of money supply in comparison with the rate of growth of economic activity.[39] This is the main purpose of the economic policy derived from government management of both outside and inside money. As a matter of fact, some writers about the economic system of Islam have overemphasized the role of money as a tool for facilitating transactions and have overlooked its use as a reserve for the future which is referred to in several sayings of the Prophet, peace be on him, which relate to making provision for tomorrow, where 'tomorrow' actually refers to the coming year. Such a use of money is also implicit in the fact that *al-Nisab* is exempted from *Zakah*, i.e., the holding, over a whole year, of such an amount of money as several

[39]Abu-Sa'ud, *op. cit.*, *p. xv.*

hundred dollars is permitted and not penalized.

In this connection Abu-Sa'ud has taken an extreme position in postulating that money should be stamped periodically so that it has a periodically decreasing value,[31] because this affects not only the money held above *al-Nisab* but also that part below it, as well as any holding of money for transactions, whenever the period is less than a full year (he suggests a period of a month). Moreover, this approach involves injustice because it does not take into account the change of hands during the period and leaves the whole burden of the stamp on the last holder, which would create large fluctuations in transactions between the beginning and the end of the period. In addition, Abu-Sa'ud's proposal discriminates between monetary and non-monetary assets, whereas *al-Zakat* does not make such a discrimination, as we have seen earlier in this study.

The Islamic Structure of Credit and Finance

a. In the Islamic system of credit and finance, commercial banks, deprived of the privilege of creating demand deposits, are required to work on a 100% reserves basis. These are mostly deposited in the central banking system or actually withdrawn from circulation; otherwise banks provide all the other interest-free services. In other words, they are service institutions rather than monetary institutions. The act of a private party opening a demand deposit account in a commercial bank implies two actions, the delivery of a certain amount of cash to the bank (this could be done by a transfer from an other deposit account or from another bank because these are backed by 100% reserves), and the creation of a demand deposit in its stead. Checks are used in the conventional way as orders to transfer entries between demand deposits. Part of the cash delivered will be retained in the bank vault—say 5% to provide for cash payments—and the rest is to be returned to the central bank; actually both parts are withdrawn from circulation. Thus the opening of an account in a commercial bank does not change the quantity of money in the society; all it does is to substitute deposits for currency. Banks do not create credit, neither do they participate in monetary policy-making.

[31] *Ibid.*, pp. 37-48.

b. Finance houses, working on the basis of *al-Qirad*, are the second major type of financial institutions in the Islamic economy. These are institutions for collecting savings deposits and providing financing for business. The finance house deals mainly with transactions other than short-term ones and participates in the real productive activity. It is not necessarily separated from the commercial bank in an independent institution; the two can be thought of as one body providing two separate services. Both are subject to the same rules as far as reserves are concerned, with only one difference: the finance house is allowed to have *Qirad* shares as reserves instead of depositing them in the central bank.

c. The third major type of financial institution in the Islamic economy is the *Zakah* Fund and its branches. Approximately 27.5% of the national income passes through this agency each year.[32] Records are maintained on the current financial status of every individual and business in the country; the agency has branches all over the country because of the localized character of *al-Zakah*. The *Zakah* Fund is an autonomous institution. These characteristics make the *Zakah* Fund the ideal agency for assuming the responsibility of 'monetary' credit within the system—that is, the credit which ends up creating money in terms of demand deposits—and for the creation of 'inside' money.

Before proceeding to examine the monetary function of the *Zakah* Fund, it may be useful for future analysis to say a word on the distinction between consumption and production credit. Production credit is credit which is granted to increase the capital assets or to finance a productive activity, while consumption credit is given to consumers to finance the purchase of goods and services needed for their households. It is simply a matter of where one draws the line which determines whether a car or a house is an item of consumption or production. Consumer's durables will be included in the consumption category, which then includes durables and perishables, each of which can be classified as luxury goods, non-luxury goods and necessities. Necessities are defined as the package of consumer goods, durable and perishable, which is required to maintain the consumer exactly at the minimum standard level, which is, as we have already seen, socially and culturally determined.[33]

[32] See pages 62-63 of this study.

[33] At the time of the Prophet, peace be on him, it included, for example, shelter, transport and means for marriage in addition to food.

To begin with, the third category of consumer goods (i.e., necessities) should be made available to everyone. Those who have no means are eligible for free help from the *Zakah* Fund in the form of money to meet their basic needs; no consumption credit is given to finance such necessities. Credit for the first category of consumables namely, luxury goods, is also excluded from the jurisdiction of the *Zakah* Fund because this spending is generally discouraged and whenever it concerns durables is also penalized. The second category of consumption purchases, which covers a very large part of the consumer's demands except in a subsistence society, is eligible for credit from the *Zakah* Fund.

Credit for productive activities, long- and short- term, is a major monetary function of the *Zakah* Fund: We will elaborate on this point further in a later section. It is sufficient for the time being to point out that, first, monetary credit is given free of charge,[34] and second, it is used as the principal tool of monetary policy through: (1) terms of loans, (2) percentage requirement of financing by the borrower. (3) eligibility requirement for credit, and (4) ceiling on aggregate credit.

Finally, it is useful to discuss credit outside financial institutions as a corollary to credit through them. We will deal here with two points: the principle of waiting, *al-Nazirah*, and the propensity of people to lend money.

Al-Nazirah refers to the postponement of payment of the debt at the request of the debtor who is facing difficulty in meeting his obligation at the due time. This is referred to in the Qur'an and it has been elaborated in Islamic jurisprudence.[35] This principle has been mentioned in the Qur'an in the context of the prohibition of *Riba* and substituting for it the Islamic organization of credit. This suggests that this principle should be developed into an effective economic tool for dealing with this kind of problem, as an intrinsic part of the system which is ready to respond to need and is beneficial in its effects on both parties. It is suggested that this principle can be applied in the establishment of a debt-clearing house to handle the postponement of payment of debts when required, and to oversee the interests of the different parties. Such a clearing house can be supported by the *Zakah* Fund or the State Treasury as

[34]This does not exclude charging the managerial costs, which are in any case negligible; however, it excludes profit sharing and, of course, interest.

[35]2:280.

the ultimate guarantors for non-paid debts. Such an institution will take care of the side effects of commercial and personal credit.

The second corollary has to do with the disposition to lend. Individuals in all communities tend to help each other in one way or another in their personal affairs, and one aspect of mutual help is a personal loan. It reflects a psychological inclination which can be measured once we specify the variables in a measurable manner. This tendency varies from one society to another according to social, religious and moral values, whether its members are social-minded or individual-minded, and the type and functioning of the social institutions. In an Islamic society, for example, individuals live in an environment which orients their behavior toward co-operation, mutual help and social-mindedness. This can be seen by investigating the social institutions of this society: family relations, marriage and neighborliness on the one hand and collective prayers five times a day together with other collective religious activities on the other, in addition to the social-mindedness and orientation toward moral and religious values, especially those which concern 'the loan out of goodness,' *al-qard al-hasan*." To sum up this point, one can talk about a psychological propensity toward lending which disposes people to give personal loans even in the absence of any material benefits derived from the loan on the side of the lender, and which is affected to a marked extent by the social values and institutions.

Now given a certain set of social, religious and moral values and institutions, the 'loan out of goodness', which can be defined as the loan which does not give the lender any direct or indirect material benefits,[36] is a positive function of wealth and income. The wealthier one is[37] and the greater one's ratio of liquid to non-liquid assets, the more one will be disposed to lend; the more one saves per period out of his income, the more he will be willing to lend. This is a negative function of the differences among individuals in wealth and income, i.e., people are more willing to lend to those who are relatively similar to them, while charity as such is given by

[36]Even if by giving a loan, one had in mind to strengthen the friendship and thus have a potential help when one needs it oneself, still no direct potential benefits are involved to the lender as long as the anticipated future help is not agreed upon or stipulated at the time the loan is granted.

[37]We have avoided the discussion of marginal and average propensity at this stage because of our belief that it needs to be preceded by an empirical analysis which can be undertaken even in a non-interest-free society. Allowance can be made for the effects of interest. A comparative study carried out in developed and under-developed countries is of great help. Some hints can be derived from the existing researches on non-obligatory transfer payments.

those who have to those who do not.

This personal borrowing can be characterized primarily as consumption credit since it does not, by the very definition of "*al-qard al-hasan*, involve any earning motivation.

Public Debt and Bonds Market

The only public debt which may be encountered in an Islamic society is a non-income bearing debt. Holding the assumption of utility maximization on behalf of the income earner to be true, trying to anticipate the size and scale of effects of such a public debt becomes very speculative. What can be said here is that this kind of debt will not come into being without the stimulus of something other than income motivation. Nevertheless, an investigation of the possibility of public debt existing in an Islamic economy is not useless. What is meant here by public debt is the short-term and long-term claims on the government which are not represented in means of payment bills (i.e., not including the issue of currency).

Public debt may serve three main purposes: (1) The financing of emergency expenditures which exceed the capacity of taxes, or, when necessary, that part of this burden which is to be carried by future generations; (2) the financing of development programs with the intention that the direct burden of them be assumed by those who will realize the benefits or gains; and (3) the absorption (injection in case of debt reimbursement) of excess (shortage) of money in the hands of the public as a tool in the hands of monetary authority.

From an ideological point of view, Islam approves the principle of shifting part of the burden of current expenditures to future generations, especially when these expenditures are of benefit not only in the present but also in the future. In fact, the other aspect of this principle, namely, keeping a share of benefits accrued as a result of current expenditures and effort for future generations is clearly mentioned in the Qur'an,[38] and it was also unanimously agreed upon by the Companions of the Prophet at the time of the second Caliph, 'Umar, after a long dispute. The application of this principle in either of its two aspects by means of public debt is doubtful unless it is a forced debt. In this respect, all the Islamic jurists approve the government's making emergency expenditures and needs by taxing the affluent whenever the ordinary means of financing are insufficient. It is evident that if the government can

[38]59:10

tax, it can also obtain compulsory loans from its citizens to finance emergencies. It should be conceded that this is an extraordinary solution for dealing with an extraordinary situation and is not a permanent means of finance. In any case public debt is not expected to be important in the Islamic economy. As a result the bonds market does not exist and private interest-bearing bonds disappear.

Instead of a bonds market, the Islamic economy has *Qirad* market. This is similar to the stock market, which may also exist in the Islamic economy.[39] This market deals with *al-Qirad*, and the price determined is the profitshare.

A concluding remark on speculative behavior, especially in these markets, is desirable here. The Islamic system does not seem comfortable with speculation.[40] Trading goods and services, stocks and *Qirad* is an economically productive activity because it presumably increases the usefulness of the exchanged things for the two parties; these kinds of transactions are the pillars of any market economy. But speculative transactions are viewed in the Islamic economy from two points of view. They are looked upon as a kind of gambling because they result in gains and losses without increasing the usefulness of the exchanged goods,[41] and they are considered from the viewpoint of the implicit intention of selling what you do not own or buying what you do not want to have.[42] On these two bases speculative transactions are prohibited.

With the exclusion of speculative transactions from *al-Qirad* and the stock market, there is room left only for real transactions which are meant for actual participation in the productive activity. This is done by delivery requirement for each transaction. Since the item of transaction in these markets represents productive capacity, the delivery of the claim certificate alone is not sufficient to prove the intention of the purchaser to participate in the company's productive activities. A certain period of holding the certificate should

[39]The principal difference between a *Muqarid* and a shareholder lies in the process of decision-making. The shareholders as a body are the decision-makers. The board of administration of the corporation works on their behalf as an agent (leaving aside the problem of how democratic the election and the representation procedures are), while the *Muqarid* is not a decision-maker in the firm, although he has some controlling authority.

[40]Speculation is defined as purchase (sale) on the expectation that prices are going to increase (decrease) without any intention of delivery, in the case of goods, or of holding the stocks *(Qirads)* to collect their dividend (profit-shares.) It is in fact a mere exchange of claims themselves and not of what they represent.

[41]Abdul-Karim al-Khatib. *As-Siyasa al-Maliyah fil-Islam*, (Cairo: Dar al-Fikr al-Arabi, 1961, pp. 170-2.

[42]Abdul-Rasul, *op. cit.*, p. 91.

therefore be stipulated between the purchase and the resale of these claims; the determination of this period is left to the monetary authority as one of the tools in its hands.

The Functioning of the Macro-Monetary System

a. If people consume all their incomes, the net investment will not exceed zero and the economy will be in a stationary state in which replacement only leads to repetition of the same quantity of output during the next period of time. Hence, what is significant from the point of view of equilibrium analysis, and also from the viewpoint of growth, is the disturbance of this stationary state, i.e., the existence of saving in real life. Saving is not a mere residual. It is not the leftover of income after consumption, unless in the very hypothetical case in which income is barely sufficent to support life. Rather, saving is a positive activity, and people are disposed to save for the sake of saving, i.e., because the accumulation of wealth produces utility.[43] in terms of prestige, opportunities for higher future income, leaving property to heirs, postponed consumption, etc. This is not to say that consumption is residual, because it is also a positive decision. This point will be clarified if we look at the marginal decision, which is a choice between saving and consumption where each of them produces utility. The utility-maximizing choice is that at which the opportunity cost, i.e., given-up consumption, equals the utility of the extra unit of wealth, saving. This is shown in Figure 3, where I is the utility function, the right hand tail of which is convergent to the horizontal axis to reveal the possibility of exhausting income by consumption, and Y is individual income, with E, the conventional Engel curve, being the equivalent of the conventional consumption function.[44] The slope of the I's measures the consumption utility given up to obtain the extra unit of saving utility, and the slope of the Y's measures the cost of this substitution. In conventional economic theory, a sum worth $106 after one period is worth $100 of current consumption, i.e., the cost of wealth per unit of current consumption is 1.06 (assuming the rate of interest to be 6%). This implies more than one slope of the income constraint.

[43]This fact is referred to in The-Qur'an 3:14 and 100:8.

[44]The Engel curve represents the relationship between the equilibrium quantity of consumption and the level of income.

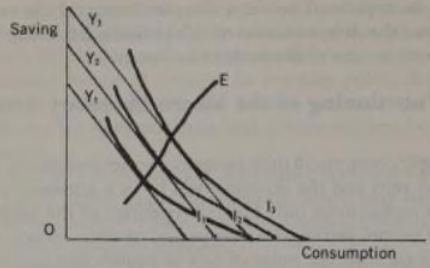

Figure 3

This is the starting point of saving-investment analysis in the Islamic economy. Saving is a disturbing element, and it is a positive function of income earnings and not a mere residual. To be more accurate, saving is disturbing whenever it is not reinjected into economic circulation as an increase in demand for producer's goods. Therefore, although *Zakah* is imposed on both productive and non-productive wealth, it acts as a penalty on non-productive wealth, i.e., savings, since *Zakah* on productive wealth is offset by the profits. This implies that the slope of Y becomes less than one because the cost of future wealth per unit of current consumption becomes 97.5/100. Two possible solutions are available. First, if the tangency point happens to be on the horizontal axis. (Figure 4), savings disappear at the given level of income; all income is used up for current consumption. This brings us to the stationary state as far as private savings are concerned.

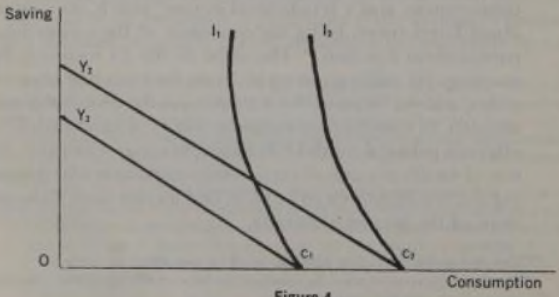

Figure 4

The second possible solution is where the tangency point is not at the border, allowing for savings to occur. Before analyzing this second and more realistic solution it is desirable to turn our attention to the non-dependence of this choice on the interest rate, as discussed in the Islamic literature. This could interpret the stability of the consumption function, as shown in the empirical studies of Kuznet and others, even in a world of non-stable interest rates. The second point to be noticed in Figure 4 is that at any level of income the tangency solution, based on *al-Zakah*, lies to the right of that based on interest. This implies more consumption bias in the second than in the first.

b. The second solution is, in fact, linked to investment opportunities because, as shown earlier, non-productive wealth will ultimately be used up by *Zakah*. Therefore a positive saving is associated with a positive net investment on behalf of the private sector. The effect of a positive net investment on the consumer's choice is a dual movement (Figure 5) toward the left along the income constraint and upward switch of Y around its horizontal intercept. The appearance of saving in the consumer's decision raises his utility to I_1 as shown in the same figure.

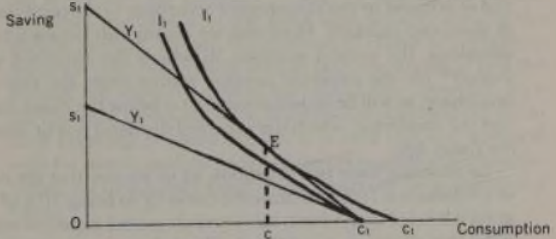

Figure 5

Note that the maximization solution moves from C_1 to E, which is the equivalent of C_1 on the current consumption axis. The similarity between Figures 3 and 5 may be misleading. A careful comparison between them shows that the first solution, C_1, is not obtainable in Figure 3 (under the normal assumptions of the indifference map and the *ceteris paribus* condi-

tions)[45] for at least any positive rate of interest. This leads to the conclusion that saving will be undertaken whatever the opportunity of investment as long as there is a positive rate of interest; that is, at the time of a deteriorated investment there is no hope that consumption will rise to offset the investment shortage as long as interest rate is positive. In the Islamic economy, the two extrema for consumption are C = Y and C = Y-I. Poor expectations of business investment have their direct and simultaneous repercussions in terms of a rise in consumption which, in turn, leads investors to review their expectations.

c. The decision to invest is not usually a unilateral one. It involves two persons or at least the collaboration of two economic actors, the entrepreneur and the financier. The latter may enter the investment process as partner, i.e., shareholder or *Muqarid*. Thus investment is basically a cooperative activity.[46] On a *ceteris paribus* assumption, investment can be said to be a function of its marginal efficiency. This is determined by the expected returns (amount of return and its duration), the purchasing value of the project, and the level of capital stock, in real terms. Aside from the conventional analysis, investment in a project has a negative relationship with the marginal efficiency of the project, the curve M in Figure 6. This rate of return on the project will, in fact, be distributed between the entrepreneur and *al-Muqarid* or the shareholder according to the conditions in these two markets. Here also we distinguish between two situations, the critical situation in which the expected dividend[47] (or the expected average return times the rate of profishare, as will be shown presently) is below the *Zakah* line, and the situation in which the expected dividend is at or above the *Zakah* line.

To illustrate these two situations, let us assume that the rate of profishare is 70% and draw the curve Q' as being 70% of M at each level of investment; this curve shows the expected marginal rate of return on *al-Qirad*. This belongs to the *Muqarid* and is the equivalent of the conventional marginal efficiency of investment schedule which is usually compared with the rate of interest in the neo-Keynesian traditions. The difference be-

[45]"Other things being equal."

[46]Once we introduce interest as price of capital, investment looses these characteristics.

[47]Conceived of in percentage terms.

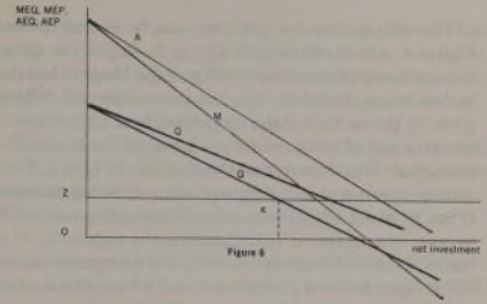

Figure 6

tween M and Q' is the rate of the remuneration of the entrepreneur, which is called profit.[48] Before introducing the *Zakah* line Z with any significance, we need two more curves in Figure 6, namely the AEP, and its profitshare counterpart, which are A and Q. In fact, these averages are the more relevant to our analysis, although it does not seem so at the first glance. It is true that the individual firm seeks the highest rate of return, i.e., marginal, when it wants to expand its capital, but under the assumption of downward sloping marginal, the highest obtainable marginal always goes with the highest obtainable average; wherever the marginal decreases, the average also decreases but it is above the marginal. Hence, by seeking the highest marginal, the firm is at the same time actually seeking the highest average. In fact, the question of choice of average or marginal does not arise as long as both the marginal and the average are above the limit of the critical zone; however, once the marginal passes this limit, the question of whether or not to keep investing becomes urgent. It is here that the analytical tools for macro-analysis do not fit the microanalysis because the individual firm is only a unit at the margin of the economy as a whole.[49]

[48]This is not to be confused with the traditional understanding of profit which is a very ambiguous term summed up as the cost of production under conditions of perfect competition, but in fact there exists no analytical process to determine it. What is normal profit and how is it determined? The traditional answer to these questions is very unsatisfactory since all the other factors of production have their own markets in which prices and quantities are determined at equilibrium, while entrepreneurship has no market. Hence profit is not determined by the market mechanism; it becomes a mere residual, the thing which makes the exhaustion theorem trivial because it is implied in its assumptions. This problem is treated in the following section.

[49]See pages 48-49.

The solution to this problem can be found by looking at Figure 7, which reproduces Figure 6. At point e, $Q' = Z$, i.e., any extra unit of investment will give the *Muqarid* less than what he has to pay in *Zakah*. The net income he will collect at I_1 is given by the surface of the rectangle Zbce. This can increase by an extra unit of investment $I'_1 - I_1$ only if the area efdh is more than gbcf. This depends on the elasticity of Q at c. The expansion of investment to the right of e requires that the elasticity of Q at c be ≤ -1.02564. Assuming this condition is fulfilled, the process of investment would go on to the right of I_1. At point I_2, the extra unit of investment will yield a negative product, i.e., will reduce the total profitshare, and whatever the elasticity of

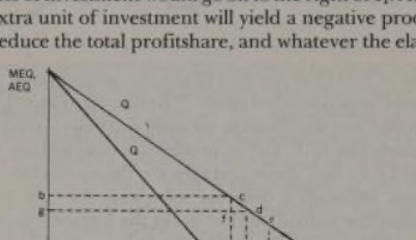

Figure 7

Q, this extra unit does not increase the net income of the *Muqarid*.[50]

The conclusion is thus reached that above the critical limit Z, investment will expand, since for any practical value of the elasticity of Q, net income is represented by the triangle above Z and below Q'. In the critical zone, the expansion of investment depends on the elasticity of Q which in turn is a function of the factors that determine MEQ. For an elasticity ≤ -1.02564, investment expands, but here also the theoretical limit is at I_2 where MEQ = O.

Keeping in mind that the variables in both Figures 5 and 7 are flows, the equilibrium position in Figure 7 at e or at a point to the right of it where the elasticity of $Q = -1.02564$ determines the size of the rightward shift of Y_1 around c_1, so that the amount $cE = cc_1$ in Figure 5 equals the amount OI_1 in Figure 7,

[50]Unless for positive elasticity at r, which is excluded by the postulate that Q from plus to minus in the neighborhood of I_2.

and the amount represented by the rectangle Zbce in Figure 7 equals the amount s_1s_1' in Figure 5. Hence whenever the *Muqarid* is at any point on Q to the left of c (Figure 7), the higher expected net income pushes saving to increase, thus enlarging s_1s_1' and shifting E upward.

Before describing the dynamics of the long run equilibrium and the role of the critical limit Z, we must now analyze the distribution of the average efficiency of the project among those who participate in the investment decision.

d. It was mentioned in footnote 49 that profit is not determined in the traditional economic theory. It is not so in the Islamic economy, in which, after paying the costs of land and labor,[51] the residual, which is represented by the curve A in Figure 6, is distributed between capital and entrepreneurship. First let us find the relation between profitshare as a percentage of AEP and dividend as percentage return on capital. At equilibrium, the return on *al-Qirad* and the return on partnership should be equal. Allowances are made for participation in decision-making and limitations of responsibility in case of partnership, i.e., shareholding.[52] The return on *al-Qirad* is the rate of profitshare times the expected average return on the project. This should equal the expected return on stocks or shares, i.e., the entrepreneur is indifferent to whether he gets money from the *Muqarid* or from a shareholder. Hence there is a one-to-one relationship between dividend and profitshare at equilibrium, represented as

$$Q = \frac{D}{AEP}$$

Any disturbance of equilibrium leads the entrepreneur to seek financing from the cheapest source, which restores equilibrium. In fact, it may be possible to consider the stocks and *al-Qirad* markets as only one market in which the profitshare Q is determined.

The capital market is similar to other factor markets as far as the demand and supply mechanism is concerned. The shape and position of the supply function are underlined by consumer preference. The demand function reveals the entre-

[51] These are determined in the factor markets. See Chapter IV.

[52] These could be very small in modern corporations, so that differences practically disappear.

preneur's preferences, see Figure 8. The fact that the vertical axis measures percentages and not absolute values is what makes the Islamic capital market different from that in traditional theory. In the traditional theory this market determines the rate of interest but not the entrepreneur's profit,[53] whereas having the price sought in percentage terms determines both profitshare and profit simultaneonsly. The demand and supply functions in this market are really more similar to the offer curves know in international trade theory than to ordinary demand and supply curves.

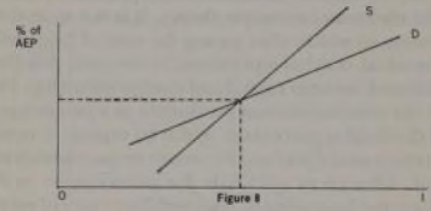

Figure 8

The other difference lies in the slope of the demand for financing which is positive in this market. This in fact reflects that, as the ratio of capital/entrepreneur rises, the profitshare offered by the entrepreneur increases in order to attract more capital. Actually this can be derived from the above equation. To keep D at some remunerative level,[54] say 7%, one needs to raise Q with an increase in capital/entrepreneur ratio, under *ceteris paribus*. But the slope of demand is always less than the slope of supply. This reflects the fact that the entrepreneur is willing to give up as little as he can for any incremental rise in financing, whereas the *Muqarid* is willing to extract as much as he can for that rise.

e. The analysis of subsections a, b and c was carried out in comparative static terms. The interaction between investment and consumption and the effect of the non-interest/*Zakah* mechanism can be better understood if we look at this interaction step by step. Suppose that Y_1 in Figure 9a represents the

[53]Abstracted from the debate between loanable funds theory and liquidity theory, which has no place in this study.

[54]Remember that this is in gross terms, i.e., before the payment of *Zakah* which is .02564.

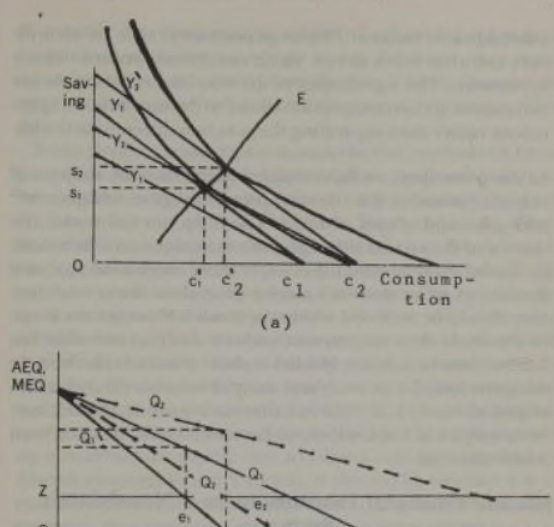

Figure 9

income in period t_1, and OI_1 in Figure 9b represents the expected investment, then consumption is determined at c_1' and saving at $Os_1 = OI_1$.

If expectations are realized at the end of the period, actual income will be in period 2 at Y_2 and potential consumption at c_2, if all of it is being consumed. This in itself gives rise to better expectations, which shift Q' and Q to the right with $Os_2 = OI_2$ and consumption at c_2', with the expansion path of income E. In the case of poor expectations, investment will shrink but this will raise consumption. It is a movement of the point c_1' toward c_1 and this in itself counteracts the shrinkage in investment. The effect of the *Zakah* deduction can be conceived of if we remember that it is in fact taken out of income to be added to aggregate demand, so that there is a direct and equivalent increase of aggregate demand to the same degree that there is

a deduction of income. This is not necessarily true for an ordinary tax; thus it is a device which counteracts contractionary movements. The significance of the non-interest principle lies in connecting the consumption choice to the investment expectations rather than separating them as two different activities.

f. In the preceding, we have avoided going into the subjects of voluntary transfer (i.e., charity, private religious obligations[55] and gifts) and *al-qard al-hasan*. These do not fall under the control of the system although their existence and role connot be denied. Nevertheless the effect of these needs to be analyzed in order to arrive at some concrete ideas about them, and then they should be included within the model. However the scope of this study does not warrant such an analysis, and what has been written by modern Muslim authors does not constitute an adequate basis for an analytical study of voluntary transfer and *al-qard al-hasan*. It is believed that such a study should start from empirical work which, so far as we know, has not been undertaken yet.

Islamic Financial Institutions in a Non-Islamic System

This section introduces that part of the Islamic literature which deals with practical proposals for establishing interest-free banking within the systems presently existing in the Muslim countries, which range from free enterprise in the Western sense to socialist attempts. These proposals are formulated on the basis of the Islamic version of the 'Second Best Theorum' which can be expressed by in the following statements:

—What cannot be achieved in totality should not be entirely abandoned.
—Wrong should be done away with.
—What is prohibited should be avoided completely, and what is prescribed should be implemented within the limits of one's capacity.
—Needs and necessities are excusable, but only within their limits.
—The main structure of the system of values is constant and absolute, as given in the Quran and the *Sunnah*.

The important difference between the Islamic and the Lancaster Second Bests' rests on the last point, i.e., the clear rejection by Islam

[55] This is mainly what is called *al-Kaffarat* in the Islamic literature.

of virtually the entire existing system of values. It implies that the constrained optimum cannot go in any direction other than the non-constrained optimum according to Islamic 'Second Best,' where according to the Lancaster theorem it may take a different direction.

Some pragmatic assumptions underlie the non-interest banking proposals. First, those who suggested these proposals hold that it is not impossible to achieve an Islamic society through the gradual implementation of parts of the Islamic views and ideals. They believe that "the implementation of any part brings the society closer to the possibility of the complete fulfillment of the whole."[56] This is a controversial issue in the Islamic literature. The radical writings see it as impractical for two reasons (1) Since they exist within a non-Islamic political system, such projects can be eliminated or diverted by the authorities, as has happened in some Muslim countries, and (2) since whether a society accepts Islam as a system of social relations or not is a matter of attitude, without the attitude of acceptance all the partial implementations in the world cannot end up converting the society into an Islamic one. One can find many Islamic elements in every society in the world, whether it is communist, capitalist or traditionally Muslim, but the existence of these elements does not make any of these societies Islamic.

The second pragmatic assumption is that the existence of such banks solve some problems of individual Muslims in avoiding interest transactions, which Islam requires no matter what the total system may be.

The third pragmatic assumption considers interest-free banking as potentially very successful and popular in Muslim countries because the masses in these countries do not want to violate the Islamic injunction against interest; they view the interest banking systems prevailing in their countries with suspicion. Hence interest-free financial institutions are the best tools for involving the masses in Muslim countries the process of economic development because such institutions can win the confidence of these masses, especially the peasants and small artisans.

All the proposals for interest-free banking are based on the principle of *al-Qirad*. In this respect, al-Sadr's volume can be considered as pioneering, although chronologically not the first, in giving the details of the manner in which such banks will function and in giving a full analysis of these functions from the point of view of the

[56]Muhammad Baqer al-Sadr *Al-Bank al-la-Ribawi fil-Islam*. Kuwait: Maktabat Jami' al-Naqi l-Ammah, no date, p. 6.

Islamic legal system. The merit of his proposal as compared with others is that he has constructed it on business concepts. While he did not depend on auxiliary elements for a successful working of his proposal, other proposals depend on motivating people by other than purely economic considerations. Al-Najjar, for example,[57] has directed his effort toward a developmental proposition for involving the peasants and small artisans in the process of saving and investment. To achieve this purpose his proposal and his empirical experiment in the small town of Mitghamr, Egypt, were both formulated in terms of "popular limited scale banks." Aziz's suggestion[58] is based, in fact, on the implicit assumption that the economic authority in the country is called for to initiate, or at least support, the establishment of such institutions to a degree that it stands ready to introduce any amendment in the legislative system to guarantee their success.

Further investigation of this point will be fruitful. Al-Sadr's proposal may constitute a platform for further refinements. For example, modern accounting techniques can solve the problem of determining the net profit of a bank for periods of less than a year, and a variety of methods can be used to reach an estimate of the profitshare of *al-Muqarid* which is accurate enough, for all practical purposes, that one does not need to take refuge from that problem in pre-valued compromises on the profitshare,[59] which have, in fact, only a negligible difference from a predetermined rate of interest. The suggested application of the principle of the reward,[60] (*Ju'ala*, as it is called in Islamic jurisprudence) as a percentage of the time deposit has only a formal difference from interest and one cannot find any difference between them as far as content is concerned. It is not the change of the names of the two parties in a deposit contract from 'bank' and 'depositor' to 'agent' and 'client' which makes the interest system an interest-free one. It was shown earlier in this chapter that profishare plays a pivotal role in the functioning of the system, and that role cannot be fulfilled if the profishare is based on a percentage of the principal of the loan as in the case of interest.

The third example of the points in al-Sadr's proposal which require furthers study is the detour he has made around the ques-

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[57]Ahmad al-Najjar; *Nahwa Stratijiatin Jadidatin lil-Tanmiyat al-Iqtisadiyah*, Beirut: Dar al-Fikr, 1969.

[58]Muhammad Aziz; *Awamil al-Najah fil-Masarif al-la-Ribawiyah*, Kuwait: Maktabat al-Manar, no date).

[59]Al-Sadr; *op. cit.*, p. 56.

[60]*Ibid.*, p. 63.

tion of interest in respect to the relation between the bank and the depositors on the one hand, and the interest-free bank and other banks on the other.[61] This circumlocutious approach may fit in with some traditional interpretations in Islamic jurisprudence but it does not fit the Islamic economic theory or practices, since trying to make a workable set-up out of one whose long-term structure is based on legal tricks is obviously undesirable.

[61] Al-Sadr; *op. cit.*, pp. 71-73.

Chapter VI

ECONOMIC POLICY

Discussion of the economic policy is usually very complicated because of the non-economic factors that always enter into such a discussion. Social, political and strategical aspects of economic policy are important and should not be isolated since life is a whole. Yet this integration must be broken down on paper for the purpose of clarifying and crystalizing a particular aspect of human life in a community. Accordingly, this chapter will concentrate on the economic aspect of the economic policy. It will consist of two sections that deal respectively with the objectives and the means of economic policy. This delimitation of the problem implies that these two sections will study economic policy from a theoretical point of view and try to answer merely those questions which are more relevant to the Islamic economic system, rather than the too many questions that pertain to present-day Muslim societies and their development. Consequently, this chapter is devoted to discussing only the goals and means of economic policy that are organic to the Islamic economic system rather than those that apply to a certain level of development.

Goals of Economic Policy

1. Maximization of the Rate of Utilization of Resources

This is the goal of development. It implies, ultimately, the full utilization of the natural and human resources available to the country. The natural resources of the earth, both above and below its surface, are the gift of God. Their neglect implies ingratitude to Him as well as disobedience to His command: "It is He Who has made the earth manageable for you, so traverse through its tracts and enjoy of the sustenance which He provides."[1]

In the Qur'an, searching for and studying the gifts of God is a way of understanding His Greatness: "Do you not see that God

[1] 67:15.

sends down rain from the sky? With it We then bring out produce of various colors, and in the mountains are tracts white and red of various shades of colors. Those truly fear Allah, among His servants, who have knowledge;"[2] "Then look (and search) for the effects of the Mercy of God. He gives life to the earth after its death. . ."[3]

The enjoyment of the gifts of God and the best of goods is one of the activities of the Believers "Say: Who has forbidden the beautiful gifts of Allah which He has raised for His servants, and the good of the things (which He has provided) for sustenance? Say: They are, in the life of this world, for those who believe."[4]

The Islamic government assumes the responsibility of development for three reasons: first, it is required to guarantee a minimum standard of living to all its citizens;[5] second, it is obliged to expend a part of its available resources for the worldwide propagation of the message of Islam; and third, it is also bound to build a strong country and a strong society which is capable of sustaining an effective ideological stand in the international arena.

2. Minimization of the Distributive Gap

This is a major goal of the economic policy of the Islamic state. It is not only derived from the injunctions of the Qur'an and *Sunnah* concerning consumer behavior such as the prohibition of extravagance;[6] but also from two major Islamic principles, namely, the principle of equal dignity and brotherhood, and the principle of the undesirability of the concentration of wealth and incomes. These two principles are laid down in the Qur'an in verses such as: "O mankind, We created you from a single (pair) of male and female, and made you into nations and tribes, that you may know each other".[7] In the process of talking about the distribution of some kinds of wealth by the state, the Qur'an mentions several types of recipients without including the wealthy among them. The reason for this exclusion is: "in order that it (wealth) may not merely, make a circuit among the wealthy from among you."[8]

This economic objective should be understood as a permanent

[2]35:27-28.
[3]30:50.
[4]7:32.
[5]See pp. 38-39.
[6]These injunctions work in the same direction as above-mentioned objective by reducing the range of the obtainable set of goods.
[7]49:13.
[8]59:7.

target of economic policy and not only as a corrective device in cases of major disturbances. The Islamic government is required to structure its economic policy so that it achieves, thorugh the functioning of the market, a minimum distributive gap, not denying the differences in capabilities and intelligence among individuals. This goal can be achieved by normal tools such as the educational system, the guarantee of equal opportunities, the distribution of *Zakah*, etc.

3. The Observance of the 'Rules of the Game' by the Economic Units

One of the integral parts of the political body of the Islamic society is the *Hisba* Agency. Its role, as defined by Ibn Taymiah, is to practice control over the social behavior, so that they do what is right and abstain from what is wrong.[9] The modern Islamic economy does not have a rigid dogmatic view of the problem of the 'consistency' of individuals' decisions. This consistency may or may not be present, depending on the set of constraints under which these decisions are made. The set of constraints adopted in the Islamic value system was analyzed in section 4 of Chapter IV. All that can be added here is that the preservation of the moral attitudes of the economic units and their improvement is a permanent objective of policy making. This is a very broad goal which can be achieved not only by help from the *Hisba* Agency but also by the educational system in the broadest sense of the word.

The statement of these three general objectives of economic policy does not imply any priority in ordering them, nor does it preclude the existence of other broad objectives or strategical goals. This is a matter which can only be decided in relation to the principles of Islam, the wisdon of the time, and the particular situation and problem faced.

Tools of Economic Policy

The tools in the hands of the economic authorities in an Islamic economy can be of a large variety, beginning with moral incentives and ending with the direct administration of the economic machinery. To put it in other words, there exists, in Islamic thought and Islamic jurisprudence, a wide range of unpronounced relationships which are left to be articulated by the intellectual and political leadership of the time. This non-specified area is called

[9] Kahf, "The Economic Views," p. 3.

"the unfilled zone" in Islamic jurisprudence by al-Sadr.[10] It is important, at the time when the gap is being filled, that the tools and means devised should be consistent with the stated objectives. A few examples may be of some help. The economic balance in society and the reduction of the distributive gap can be approached by direct redistribution of the means of production. This was done at the time of the Prophet, peace be on him, among the residents of and the immigrants to *al-Madina*. Some part of government revenues may be distributed among the needy, as is enjoined by the Qur'an.[11] Production and employment policy can be used in the public sector. This gap can also be narrowed by the mere functioning of the two devices of *Zakah* and the system of inheritance, or by any other means which fits the desired objective. The political choice determines the tools which are to be used within the freamework of the system.

For better understanding of the meaning of the political choice of the tools in the perspective of the Islamic system, one should distinguish between the normal economic policy and the economic policy meant for emergencies. In the case of an emergency such as a war or the need for drastic and fast changes in the socio-economic structure, the economic tools can be radical and sharp. These can be studied as part of the economics of war. In normal cases, the pursuit of the objectives of the society does not require any drastic measures. Given the right circumstances, the smoothly-functioning system proceeds toward its objectives. The economic policy is expected, under normal conditions, to assist with the automatic functioning of the system, to remove the obstacles, and/or to correct the mistakes made here and there. This distinction is very important because it enables us to understand the remarkable discrepancy among writers on Islamic economics concerning problems such as nationalization, public ownership of the means of production, administered prices, central decision making, etc., through identification of the problem a particular writer is attacking.

Throughout this book, the approach has been to study the system as applied to the normal economy and not to exceptional cases. An attempt has been made to analyze the pattern of Islamic economics in a growing economy not faced with emergencies. This approach has been selected on the assumption that in exceptional circumstances, the decisions of leaders will have to be resorted to

[10] Al-Sadr, *Iqtisaduna*.
[11] 59:7.

and they will become more decisive than the normal pattern of the system.

Before stating the main tools of economic policy, it is important to re-emphasize the significance of the permanent existence of government in the market. This principle accrues from the recognition, in Islamic thought, of the fact that the pursuit of private interest does *not* necessarily end up in securing the collective interests.

The main tools in the hands of economic authority are, although by no means exclusively, as follows:

1. Monetary tools: These include;
   i. The management of currency and, more significantly, the management of interestless credit which might be administered by the *Zakah* Fund. The credit policy includes both its level and its distribution among various alternatives. Using this tool, the authority can introduce the desired changes upon the level of profitshare as well as the allocation of capital.
   ii. The percentage of monetarization of *al-Zakah* for both collection and distribution. The monetary authority, by administering the percentage of *al-Zakah* which will be collected or distributed in money terms, can influence the commodity market as far as the supply of commodities is concerned.

   The efficacy of these tools depends on several factors. The most important among them is the share of *Zakah* in the total net national product; it is high, as has been shown earlier.
2. Fiscal tools:
   Viewed in the same way as in the conventional use of the term, these consist of three branches: taxation, expenditures, and transfers and subsidies.
3. Production tools:
   With public enterprise assuming the important role discussed in Chapter IV, the production policy of the public sector becomes a very influencial factor in the private decision concerning allocation of resources.
   The allocation of private resources, whether capital or labor, can be directly oriented in some cases.[12]
4. Distribution tools:
   These concern the allocation of wealth and income

[12]See pp. 38-39.

among individuals rather than uses. The major distributive tool in the hands of the authority is the distribution of *al-Zakah*. *Al-Zakah*, in this respect, serves two distributive purposes: the redistribution of income among the needy and the affluent, and the allocation of it between consumption and investment, i.e., the intra-generation distribution of income. In this regard, *al-Zakah* is more of a "social tax" than merely an ordinary tax.

Vocational education, training, rehabilitation and employment policy are also distributive tools.

5. Law enforcement and compliance with moral standards: It is the last but not least tool in this classification. There are two main agencies for this purpose: the system of justice, and the *Hisba* Agency.

CONCLUDING NOTES

The Alternative Way

The Islamic economic system is often presented as a third line of thought in the attempt to understand man and his relationships with things. Its proponents believe that the Islamic approach is more moral in its points of departure and more pragmatic in its applications. The two other economic systems, namely capitalism and communism, are condemned by the defenders of the Islamic alternative as extremist to the left or to the right and hence biased in their solutions. Numerous examples may be mentioned in this regard from the historical experience of Western Europe and the United States from the time of the industrial revolution to the present. These examples will show clearly how destructive and immoral unlimited freedom can be when it is not contained within a religious framework. Similar examples of the degradation of humanity can be seen in the Soviet Union's historical experience. Due to the onesidedness of these two systems, the proponents of the Islamic solution predict that they will come closer and closer to each other and will meet midway at a point which is that of the Islamic solution.

Two points of clarification will help prevent a possible misunderstanding. The first is the important distinction between the economic system and the economics of emergencies such as war, severe depression or extreme backwardness, in spite of the fact that some emergencies may be long-term phenomena in the life of nations. The significance of this distinction lies in that the economic system deals with the functioning of a normal economy, i.e., with a healthy, growing society in which the economic institutions are mature. The validity of the system can be measured by the degree of achievement of its broad objectives. As for emergencies, the economic system can only give general and broad guidelines. Some of its details, modes of influence and techniques may be suspended while others may be intensified. In emergencies, the wisdom of the

time and the values and directives of the economic philosophy are what are relied upon in searching for an optimum path. In this book the concern has been to investigate the economic system of Islam in order to present the general case, and hopefully in later works to proceed to the analysis of special cases which will bridge the gap between the general theory and the particular conditions and problems of given countries such as development, distributive justice, inflation and economic fluctuations. This is not meant to downgrade the significance of the second kind of studies, in particular in the area of Islamic developmental theory, since these are probably the most relevant to the presently-existing situations in the Muslim countries.

The second point is the distinction between 'Islamic' and 'Muslim'. 'Islamic' refers to what pertains to Islam as a religion, an ideology and a system of life, while 'Muslim' refers to the actual way of life in what are conventionally known as Muslim countries. This book has dealt with 'Islamic' and not with 'Muslim.'

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